No. (1)
Supreme Court, U.S.
FILED
04 163 JUL 30 2004
CLERK

In The
Supreme Court of the United States

LINDA LINGLE, GOVERNOR OF THE STATE OF HAWAII, and MARK J. BENNETT, ATTORNEY GENERAL OF THE STATE OF HAWAII,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Just Compensation Clause authorizes a court to invalidate state economic legislation on its face and enjoin enforcement of the law on the basis that the legislation does not substantially advance a legitimate state interest, without regard to whether the challenged law diminishes the economic value or usefulness of any property.

2. Whether a court, in determining under the Just Compensation Clause whether state economic legislation substantially advances a legitimate state interest, should apply a deferential standard of review equivalent to that traditionally applied to economic legislation under the Due Process and Equal Protection Clauses, or may instead substitute its judgment for that of the legislature by determining *de novo*, by a preponderance of the evidence at trial, whether the legislation will be effective in achieving its goals.

PARTIES TO THE PROCEEDINGS

The parties to the proceedings below were petitioners Linda Lingle, the Governor of Hawaii, and Mark J. Bennett, the Attorney General of Hawaii, and respondent Chevron USA, Inc. Pursuant to Fed. R. App. P. 43(c)(2), Linda Lingle was substituted below for her predecessor as Governor, Benjamin J. Cayetano, and Mark J. Bennett was substituted below for his predecessors as Attorney General, Earl I. Anzai and Margery S. Bronster. (The opinion of the Ninth Circuit issued on April 1, 2004 erroneously listed former Attorney General Bronster as a defendant and misspelled Attorney General Bennett's name; the court amended its opinion on April 15, 2004 to correct the caption. The amended opinion is reprinted in the appendix hereto.)

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OPINIONS BELOW

The Ninth Circuit's opinion (App. 1) is reported at 363 F.3d 846. The District Court's opinion (App. 30) is reported at 198 F.Supp.2d 1182. The Ninth Circuit's earlier decision reversing summary judgment and remanding for trial (App. 54) is reported at 224 F.3d 1030. The District Court's initial decision (App. 94) is reported at 57 F.Supp.2d 1003.

JURISDICTION

The Ninth Circuit entered its judgment on April 1, 2004. On June 21, 2004, Justice O'Connor extended petitioners' time to file a petition for *certiorari* to July 30, 2004. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTE INVOLVED

The Fifth Amendment to the Constitution provides in relevant part: "No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." The Fourteenth Amendment provides, in Section 1: "No state shall . . . deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." The relevant portions of Act 257, Haw. Rev. Stat. § 486H-10.4 (1997), are reprinted at App. 121.

STATEMENT OF THE CASE

1. The State of Hawaii is "physically small and geographically remote." Act 257, § 1(4). As a result, its economy is unusually subject to risk of oligopolistic concentration. This risk is particularly evident in the market for oil products in the state. Hawaii is served by only two refiners, and the wholesale market for gasoline on Oahu,

the state's most populous island, is divided among only six companies. The retail market for gasoline is protected from similar high concentration, however, by the presence of numerous gas station operators who lease stations from oil companies and set pump prices independently.

To maintain the benefit for consumers of a multiplicity of independent lessee-dealerships, the Hawaii legislature enacted Act 257. The Act prohibits oil companies from converting lessee-dealer stations to company-operated stations, and from locating new company-operated stations in proximity to existing lessee-dealer stations. In addition, to prevent oil companies from increasing rents to drive independent dealers out of business, § 3(c) of the Act limits the maximum rent that oil companies may charge dealers. Although Act 257 employs rent regulation to achieve its goals, it was not enacted primarily for the benefit of dealers paying rent (in contrast to, for example, an apartment rent control measure intended primarily for the benefit of rent-paying tenants). Rather, the Act is intended to stabilize the present structure of the retail market for gasoline, preserving the long-term benefit for consumers of multiple retail vendors and averting the economic harm that would occur if the retail market, like the wholesale market, were to become concentrated in the hands of the few oil companies serving the islands.[1]

2. Chevron USA, Inc., the largest refiner and marketer of gasoline in Hawaii, sued the Governor and Attorney General of Hawaii, claiming that the rent cap imposed by Act 257 on its face effects an unconstitutional taking of Chevron's property and violates due process and equal

[1] Although the purpose of the Act is plainly prophylactic, the Ninth Circuit misapprehended this point. The Ninth Circuit characterized the purpose of the law as "lowering retail gas prices," App. 18, erroneously implying that the Act was intended to *reduce* prices for gasoline from current levels rather than to ward against potential *increases* in such prices if lessee-dealers were driven from the marketplace.

protection. Chevron sought declaratory and injunctive relief, but did not request compensation. Chevron subsequently stipulated that, including its earnings from the sale of gasoline, "Chevron has earned in the past and anticipates that it will earn in the future, at the rent levels allowed by Act 257, a return that satisfies any Constitutional standards on its investment in lessee dealer stations in Hawaii." C.A. Excerpts of Rec. ("ER") 60.[2]

In 1998, the District Court granted Chevron summary judgment on its claim that § 3(c) of Act 257 effects a taking. The court rejected the State's argument that it should employ the deferential standard traditionally applied in the review of economic legislation under the Due Process Clause. Relying on language in *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980), the court held that the rent cap in Act 257 "does not substantially advance legitimate state interests," and enjoined the State from enforcing § 3(c) of the Act. App. 118. Chevron then voluntarily dismissed its due process and equal protection claims without prejudice.

3. On appeal, the Ninth Circuit held that the District Court had applied a correct standard of review under the Just Compensation Clause, but vacated the grant of summary judgment and remanded for trial. The court read a previous circuit decision, *Richardson v. City and County of Honolulu*, 124 F.3d 1150 (9th Cir. 1997), to foreclose the State's argument that a deferential, rational-basis standard of review should apply. Rather, the court stated that "a challenged regulatory action 'substantially advances' its interest if it bears a reasonable relationship to that interest," and concluded that "[w]hether Act 257's rent cap is reasonably related to its objective of lowering fuel prices

[2] Chevron also stipulated that the cap on permissible rent established by Act 257 was *higher* than the rent that it would otherwise have charged for 53 of the company's 64 lessee-dealer stations, and that Act 257 allows Chevron to recover more rent in aggregate from its lessee-dealer stations than it would otherwise charge. ER 56-57, 66-68.

certainly depends on whether it will in fact lead to lower fuel prices." App. 76. Finding that the affidavits before the trial court did not resolve that question, the Court of Appeals directed the District Court on remand to use trial procedures, including assessment of the credibility of the parties' expert witnesses through cross-examination, to determine as a matter of "predictive fact" whether the statute will achieve its goals. App. 69-72.

Judge William Fletcher concurred in the Ninth Circuit's disposition, but disagreed with the majority's analysis. App. 79-93. Judge Fletcher contended that this Court's precedents require that rent controls and other price controls be evaluated under a deferential standard of review, rather than the heightened "substantially advance" standard employed by the majority.

4. On remand, the District Court held a one-day evidentiary hearing at which the parties each presented a single expert economist to give his opinion on the effectiveness of Act 257's rent cap in protecting Hawaii's consumers. Chevron's expert argued that dealers will be able to capture a premium reflecting the economic benefit of the rent cap if they sublease their stations to new dealers, making the law ineffectual to the extent it aimed at lowering dealer costs. He also opined that oil companies will try to recoup at least part of any lost rent by increasing the wholesale gasoline prices charged to their dealers, undermining the goal of controlling gasoline prices. Finally, Chevron's expert argued that the rent cap will discourage oil companies from investing in new lessee-dealer stations, leading over time to fewer such stations. ER 105-110. Chevron's expert did not deny, however, that the law would prevent oil companies from using rent increases to displace lessee-dealers.

The State's expert testified that, by helping to maintain the existence of lessee-dealers as independent price-setters, Act 257 protected Hawaii's consumers from the economic harm that would result if the retail gasoline

market were controlled directly by the few oil companies serving the state. He testified that the legislation would achieve this goal whether or not existing dealers could capture a premium upon subleasing, because the rent cap would in any case preclude the oil companies from raising rents to the point of driving dealers out of business. He contested Chevron's contention that the oil companies would rationally attempt to raise wholesale prices, noting that such a strategy would lead to reduced sales volume and net revenues. He also disputed Chevron's suggestion that the rent cap would deter the oil companies from investing in new lessee-dealer stations, pointing out that the oil companies were not building such stations anyway, and opined that consumers would benefit as long as some number of lessee-dealers remained in the retail market. ER 135-142.

Finding the economic theories presented by Chevron's expert "more persuasive" than those of the State's expert, App. 43, the District Court concluded that Act 257 does not substantially advance a legitimate state interest and therefore effects a taking of Chevron's property. App. 53. The District Court acknowledged that the rent cap would prevent oil companies from raising rents to levels designed to drive lessee-dealers out of business, but it discounted this justification for the Act because it did not believe that oil companies would attempt such constructive eviction.[3] App. 48, 52.

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[3] The District Court overlooked testimony that oil companies found company-operated stations more profitable than leased stations, as well as the testimony of Chevron's own expert that he had served as an expert for oil companies in many cases where dealers alleged that the oil companies had raised their rents in order to drive them out of business. ER 154-58, 163-65. Congress has repeatedly recognized the anticompetitive practices of the oil industry toward independent retailers. *See, e.g.*, S. REP. NO. 102-450, at 3-4, 6 (1992) (noting oil companies' use of "massive rent increase[s] . . . that would assure the economic eviction of the dealer"). Congress enacted the Petroleum

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5. On appeal once more to the Ninth Circuit, the State argued that Chevron's claim that Act 257 does not "substantially advance a legitimate state interest" properly lies under the Due Process Clause, rather than the Just Compensation Clause. The State also argued that the District Court should have deferred to the rational economic judgment of the legislature that the rent cap would benefit consumers. The Court of Appeals held that these arguments were barred by law of the case established in its previous decision. With respect to the State's argument that challenges to the rationality of legislation properly belong under the Due Process Clause, the Court of Appeals remarked that the "varying opinions" of the Supreme Court "suggest confusion over the relationship between due process and takings claims." App. 10. The Court of Appeals nonetheless concluded that this Court had not clearly repudiated the "substantially advance" takings formulation, and held that the panel's prior decision resolving this issue was not clearly erroneous. App. 11-13. The Court of Appeals also concluded that this Court's decisions require a heightened, "intermediate" standard of review for claims under the Just Compensation Clause that laws do not substantially advance legitimate state interests. App. 14-17. The Court of Appeals did not consider whether the statute would be sustained under a deferential standard.[4]

Marketing Practices Act, 15 U.S.C. §§ 2801-2806, to restrain oil companies from replacing lessee dealers with company-owned stations. The federal statute does not directly restrain rents charged by oil companies, however, as Act 257 does.

[4] The State also pointed out that the District Court found that Act 257 would prevent constructive eviction of the lessee-dealers in Hawaii. This finding, the State argued, establishes that the law in fact substantially advances the State's goals. The Ninth Circuit rejected that argument, stating that the State "does not challenge the district court's conclusion of law that Act 257 fails to advance Hawaii's goal of lowering retail gas prices," but "focuses instead on whether Act 257 advances

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Judge Fletcher dissented, repeating his view that the "substantially advance" takings test was incorrectly applied to the rent cap imposed by Act 257:

> We took a wrong turn in *Richardson*, we continued on the wrong path in *Chevron I*, and we are now in the wrong place. Under the panel's holding, virtually all rent control laws in the Ninth Circuit are now subject to the "substantially advances a legitimate state interest" test, and many of those laws may well be held unconstitutional under that test. Rent control is often inefficient and sometimes unfair. But we should not confuse inefficiency and unfairness with unconstitutionality.

App. 29 (internal quotes and citations omitted).

REASONS FOR GRANTING THE PETITION

The Ninth Circuit's decision in this case raises two closely related issues of constitutional law that call out for

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another purported purpose," namely, maintaining the existence of an independent body of gas station operators "for their own sake." App. 18. These remarks by the Ninth Circuit misstate the State's position. First, although the State did not dispute whether the statute would directly reduce *current* gasoline prices, it squarely challenged the District Court's conclusion of law that the statute did not substantially advance the State's goals of protecting consumers. The State argued that by maintaining the viability of lessee-dealers, the Act will avert *future* harm, in the form of increased gasoline prices, that would result if independent retail gasoline vendors were eliminated. Second, the State never suggested that maintenance of the lessee-dealers was an end in itself; Hawaii's position has always been that Act 257 seeks to maintain the viability of independent lessee-dealers *as an essential means* to avoid the economic harm of oligopolistic concentration in the retail market for gasoline. This understanding of the Act is supported by its numerous provisions aimed at protecting lessee-dealers from economic pressure from the oil companies and by its legislative history, which confirms the legislature's intention to "provide certain protection for dealer operated retail service stations." Conference Comm. Rep. No. 38, reprinted at App. 124.

resolution by this Court. Both questions implicate fundamental concerns about the proper balance between the judiciary and institutions of democratic governance, and between the national government and the states within our federal system. The first question is whether challenges to a law's substantive validity – that is, the law's reasonableness or efficacy in accomplishing the government's objectives – properly lie under the Just Compensation Clause at all. If so, the second question is whether courts should employ a deferential "rational-basis" standard of review for such challenges, as they unquestionably would if the same inquiry were undertaken under other constitutional rubrics, such as the Due Process Clause. This Court has recently identified the first question as an open, important issue, and there are conflicts as to both issues in the federal appellate courts and the highest courts of several states.[5] The Court should grant review of both questions to make clear that the Just Compensation Clause cannot be employed to second-guess the reasonableness of legislative policy judgments, but rather exists to ensure – as the text of the Clause makes clear – that, when the government does take private property for public use, it must pay compensation.

[5] At least ten other petitions for *certiorari* have been filed in the past several years requesting that the Court resolve either or both of these issues. In *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687 (1999), the Court granted *certiorari* to resolve issues related to the application of the "substantially advance" test, but did not reach the validity of that test for procedural reasons. In *Yee v. City of Escondido*, 503 U.S. 519 (1992), the Court declined to consider the validity of a regulatory taking claim based on the "substantially advance" theory because the issue was not fairly included within the Court's grant of *certiorari*.

I. Whether The Just Compensation Clause Authorizes Judicial Scrutiny Of The Reasonableness Or Efficacy Of Legislation Is An Open Question In This Court, And Is An Issue Of Fundamental Importance On Which Lower Courts Are In Conflict

A. This Court Has Noted The Uncertainty As To Whether A Regulation May Be Deemed A "Taking" Solely Because It Does Not Substantially Advance A Governmental Interest

Every Justice of this Court has recently authored or joined in opinions acknowledging that it is at least an open question whether a law may be challenged as an unconstitutional "taking" on the ground that it does not substantially advance a governmental interest. Moreover, five Justices have endorsed the view that such a challenge does not lie under the Just Compensation Clause at all.

In *Agins*, this Court stated that a regulation may effect a taking "if the ordinance does not substantially advance legitimate state interests." 447 U.S. at 260. For that proposition, *Agins* cited and discussed only due process decisions, *Nectow v. City of Cambridge*, 277 U.S. 183, 188 (1928), and *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926).[6] The Court in *Agins* did not articulate in detail the nature of the legal inquiry intended by that language, or the relevance of the rationality of government action to a claim brought under the Just Compensation Clause. Outside the special context of exactions of real property, the Court has never squarely relied upon the

[6] In *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 127 (1978), the Court similarly relied upon due process case law, including *Nectow* and *Euclid*, in suggesting in *dictum* that a regulation "may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial public purpose."

Agins means-ends test to invalidate a government regulation under that Clause.

In *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), five Justices directly challenged the validity of the *Agins* language as a test for the existence of an unconstitutional "taking." Justice Kennedy, concurring in the judgment, observed that the *Agins* formulation, calling for "normative consideration[] about the wisdom of government decisions," is in "uneasy tension with our basic understanding of the Takings Clause":

> As its language indicates, and as the Court has frequently noted, [the Takings Clause] does not prohibit the taking of private property, but instead places a condition on the exercise of that power. This basic understanding of the Amendment makes clear that it is designed not to limit the governmental interference with property rights per se, but rather to secure compensation in the event of otherwise proper interference amounting to a taking.

Id. at 545 (quoting *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 314-15 (1987)) (internal quotation marks omitted). He concluded: "Given that the constitutionality of the [statute] appears to turn on the legitimacy of Congress' judgment rather than on the availability of compensation ... the more appropriate constitutional analysis arises under general due process principles rather than under the Takings Clause." *Id.* Justice Breyer, writing for four dissenting Justices, agreed that inquiry into the legitimacy of government action is inappropriate under the Just Compensation Clause: "[A]t the heart of the Clause lies a concern, not with preventing arbitrary or unfair government action, but with providing *compensation* for *legitimate* government action that takes 'private property' to serve the 'public' good." *Id.* at 554 (second emphasis added). Even if these congruent conclusions from five Justices do not technically constitute a holding rejecting the *Agins* formulation,

Eastern Enterprises clearly indicates that a majority of the Court doubts the validity of that test.

In *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687 (1999), the Court reviewed an application of the "substantially advance" test, but declined to resolve the validity of this ostensible takings test since the city itself drafted the jury instructions incorporating that standard. However, the Court acknowledged that, outside the special context of exactions, it has never provided a "thorough explanation of the nature *or applicability* of the requirement that a regulation substantially advance legitimate public interests." *Id.* at 704 (emphasis added). In separate opinions, five Justices expressly reserved the question whether the "substantially advance" formulation represents a valid test under the Just Compensation Clause. *Id.* at 732 n.2 (Scalia, J., concurring) ("As the Court explains, petitioner forfeited any objection to this standard, ... and I express no view as to its propriety."); *id.* at 753 n.12 (Souter, J., dissenting) ("I offer no opinion here on whether *Agins* was correct in assuming that this prong of liability was properly cognizable as flowing from the Just Compensation Clause of the Fifth Amendment, as distinct from the Due Process Clauses of the Fifth and Fourteenth Amendments.").

The Court's earlier decisions in *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), and *Dolan v. City of Tigard*, 512 U.S. 374 (1994), did invoke the "substantially advance" formulation to address the special problems posed by permit conditions mandating public access to private property. The Court has made clear, however, that the rules developed in those cases, requiring that such exactions have an "essential nexus" with and be "roughly proportional" to the government's concerns, do not apply more broadly to denials of permits or other regulatory actions. *See Del Monte Dunes*, 526 U.S. at 703. Nor do those standards apply to general legislation. *See Dolan*, 512 U.S. at 391 n.8. This Court's invocation of the

Agins formulation in *Nollan* and *Dolan* in no way diminishes the Court's recognition in subsequent decisions that its validity as a general test for regulatory takings represents an important, unresolved issue.

B. Whether The Just Compensation Clause Authorizes Judicial Review Of The Rationality Of State Legislation Is A Question Of Fundamental Importance

The Ninth Circuit's view that a statute may be enjoined as an unconstitutional "taking" on the ground that it fails to advance legitimate government interests, if allowed to stand, would effect a dramatic change in takings jurisprudence. The Ninth Circuit's position is contrary to this Court's long-settled understanding that the purpose of the Just Compensation Clause is to ensure compensation for appropriations of property and regulations of equivalent severity, not to act as a substantive check on the government action in the first instance. As this Court said in *First English*, "[t]his basic understanding of the [Clause] makes clear that it is designed not to limit the governmental interference with property rights *per se*, but rather to secure *compensation* in the event of *otherwise proper* interference amounting to a taking." 482 U.S. at 314 (second emphasis added). Apart from the special context of exactions, this Court has never deviated from that "basic understanding" of the Just Compensation Clause.[7]

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[7] Numerous commentators have argued that it is anomalous to test the validity of legislation under the Just Compensation Clause. *See, e.g.*, Frank Michelman, *The Jurisprudence of Takings*, 88 COLUM. L. REV. 1600, 1605-14 (1987); Jerold Kayden, *Land-Use Regulations, Rationality, and Judicial Review: The RSVP in the* Nollan *Invitation*, 23 URB. LAW. 301 (1991); Thomas E. Roberts, Karen Edginton Milner, Robert I. McMurry, *Land-Use Litigation: Doctrinal Confusion Under the Fifth and Fourteenth Amendments*, 28 URB. LAW. 765, 769-70 (1996).

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This Court's regulatory takings jurisprudence thus presupposes that a government regulation serves a valid public purpose. *E.g., Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922) ("The protection of private property in the Fifth Amendment presupposes that it is wanted for public use, but provides it shall not be taken for such use without compensation"). Indeed, a government action *must* serve a valid public use if it is to be treated as a taking that would require compensation. In *Brown v. Legal Foundation of Washington*, 123 S. Ct. 1406, 1417 (2003), for example, the Court stated that the precondition for any exercise of the government's taking power is that the government action serve a "public use," which the Court equated to a requirement of "legitimacy" of the government action. *See also Palazzolo v. Rhode Island*, 533 U.S. 606, 635 n.* (O'Connor., J., concurring) (question whether regulation serves a valid public use is distinct from the question of whether a regulation effects a compensable taking). The Ninth Circuit's embrace of the "substantially advance" test, however, leads to the untenable position that the substantive *legitimacy* of government action is a prerequisite for a valid takings claim *and* that substantive *illegitimacy* provides an independent basis for establishing a taking. Both of these propositions cannot be correct. Because the Ninth Circuit apparently believed itself compelled by language in this Court's decision in *Agins* to produce this strange result, this Court's review is necessary to resolve this confusion.

The Ninth Circuit's approach is particularly incongruous where, as here, it is stipulated that the government

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Academic critics of the Court's *Agins* formulation include prominent scholars who generally argue for a broad reading of the Just Compensation Clause. *See, e.g.*, John E. Fee, *The Takings Clause as a Comparative Right*, 76 S. CAL. L. REV. 1003, 1035-36 (2003); Steven J. Eagle, *Substantive Due Process and Regulatory Takings: A Reappraisal*, 51 ALA. L. REV. 977, 978 (2000).

regulation will not have any significant adverse economic effect on the property owner. *See* p. 3, *supra*. This Court's regulatory takings jurisprudence focuses primarily if not exclusively on whether the economic burden imposed by government action "goes too far," *Mahon*, 260 U.S. at 415, such that the government may proceed if, but only if, it pays compensation. A regulatory taking is understood to be the equivalent of a physical appropriation precisely because of the severity of the economic impact that it works upon the property owner. *See Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992); *Penn Central*, 438 U.S. at 124. Under the Ninth Circuit's mistaken view, however, a law may be invalidated as a regulatory taking merely because a court deems it ineffective, even if its economic impact is slight (or nonexistent).

This Court's settled understanding that the Just Compensation Clause affords compensation for economically onerous government action affecting property interests – not a mechanism for substantive judicial review of the efficacy or wisdom of the government action – also explains why this Court has consistently stated that (with narrow exceptions), the ordinary remedy for a violation of the Just Compensation Clause is just compensation, not invalidation of a government regulation. *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1016 (1984) ("Equitable relief is not available to enjoin an alleged taking of private property for public use"). By contrast, the Ninth Circuit has ruled that the appropriate remedy for a taking under the "substantially advance" theory is an injunction rather than compensation, because the premise of such a claim is that the government lacks the authority to act. *Daniel v. County of Santa Barbara*, 288 F.3d 375, 384-85 (9th Cir. 2002). The Ninth Circuit's novel injunctive remedy for a taking under the substantially advance test is inconsistent

with *Ruckelshaus*, providing another reason for the Court to grant review in this case.[8]

More fundamentally, as the State explains in greater detail in Part II, *infra*, the Ninth Circuit's improper incorporation of substantive due process analysis into takings doctrine has provided a pretext for that court's improper judicial invalidation of state legislation based on an intrusive standard of review of economic legislation not seen since the days of *Lochner v. New York*, 198 U.S. 45 (1905). It has long been settled that, under the Due Process Clause, the courts owe the legislature great deference in reviewing the wisdom and effectiveness of economic legislation. *See Williamson v. Lee Optical Co.*, 348 U.S. 483, 488 (1955). Yet now the Ninth Circuit has adopted, without any real explanation or justification, the position that the courts may and should engage in intrusive means-ends review of economic legislation under the Just Compensation Clause that would be obviously and completely out of bounds if the claim were brought under the Due Process Clause.[9] That position cannot be sustained

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[8] Consistent with the view that injunctive relief is an appropriate remedy under this takings theory, the Ninth Circuit has also ruled that a claimant raising a "substantially advance" taking claim may file suit immediately in federal court and has no obligation to exhaust available state compensation procedures in compliance with *Williamson County Regional Planning Comm'n v. Hamilton Bank*, 473 U.S. 172 (1985). *See, e.g., Daniel, supra*, 288 F.3d at 385. The ability of takings claimants invoking this theory to avoid state exhaustion requirements, combined with the heightened level of scrutiny under Ninth Circuit precedents, means that litigants challenging state and local regulations will routinely file in federal rather than state court. Thus, the issue raised by this case has significant implications for forum shopping between the federal and state courts, as well as for the potential burdens such claims may impose on federal courts.

[9] There is no theory that justifies transplanting due process analysis into takings soil. To the contrary, given the differences in language between the Just Compensation and Due Process Clauses, it is more logical to conclude that these two provisions provide different rather than overlapping types of protections for private property

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under the Court's long-settled understanding of the Just Compensation Clause.

C. The Lower Courts Have Reached Conflicting Conclusions About The Proper Role Of The Just Compensation Clause In Judicial Review Of Government Action

In the absence of definitive guidance from this Court about the proper role of the Just Compensation Clause in challenges to the substantive validity of government action, lower appellate courts (both state and federal) have reached widely divergent conclusions, including many decisions in conflict with the decision below in this case. The Ninth Circuit's decision conflicts directly with state supreme court decisions holding that challenges to the rationality of government regulation must be brought under the Due Process Clause, not the Just Compensation Clause. *See Brunelle v. Town of South Kingston*, 700 A.2d 1075, 1083-84 n.5 (R.I. 1997) ("[T]he arbitrariness or capriciousness of a particular state action is properly examined under the light of the Fourteenth Amendment due process clause and not the Fifth Amendment takings clause."); *Mission Springs Inc. v City of Spokane*, 954 P.2d 250, 258 (Wash. 1998) (claim of arbitrary action by municipality in withholding building permit was not "appropriative governmental action" within the scope of Just Compensation Clause). The Ninth Circuit's decision also conflicts with state supreme court decisions holding that a taking claim must be based on economic harm to affected property interests, and may not be predicated simply on the application of an invalid regulation. *See Tampa-Hillsborough County Expressway Authority v. A.G.W.S.*

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interests. *See Harmelin v. Michigan*, 501 U.S. 957, 978 n.9 (1991) ("When two parts of a [single constitutional amendment] use different language to address the same or similar subject matter, a difference in meaning is assumed.").

Corp., 640 So.2d 54, 56-58 (Fla. 1994) (clarifying that a prior decision invalidating a statutory mechanism for land use planning was based upon due process principles, out of concern that claimants would seek unfair windfalls under the Just Compensation Clause by arguing that ordinance failed to advance a legitimate state interest); *Pheasant Bridge Corp. v. Township of Warren*, 777 A.2d 334, 343-46 (N.J. 2001) (application of an invalid ordinance to plaintiff's property is not the "'otherwise proper [governmental] interference' that the Takings Clause presupposes").[10]

The Ninth Circuit's decision also conflicts with decisions of other federal circuits. *Simi Investment Co. v. Harris County*, 256 F.3d 323 & n.3 (5th Cir. 2001) (although the Just Compensation Clause covers many landowner complaints about intrusions on property rights, challenges to government action as "illegitimate and arbitrary" lie under the Due Process Clause); *Restigouche, Inc. v. Town of Jupiter*, 59 F.3d 1208, 1211 n.1 (11th Cir. 1995) (the Eleventh Circuit "does not recognize [substantially advance takings claims] as distinct, viable federal constitutional claims in the zoning context"). The Ninth Circuit's decision also cannot be reconciled with decisions of the Federal Circuit holding that the legitimacy of the government's action is a *precondition* for a claim for just compensation against the United States. *See, e.g., Rith Energy, Inc. v. United States*, 270 F.3d 1347, 1352 (Fed. Cir. 2001); *Florida Rock Industries, Inc. v. United States*, 791 F.2d 893, 898-900 (Fed. Cir. 1986). The Court of Federal Claims, with jurisdiction over virtually all takings claims against the United States, has held that allegations

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[10] Other state courts, however, have endorsed the *Agins* formulation as a test for the substantive validity of a state law, reflecting the ambiguity of this Court's decisions. *See, e.g., Sheffield Development Co., Inc. v. City of Glenn Heights, Texas*, __ S.W.3d __, 2004 WL 422594 (Tex. 2004); *State ex rel. Shemo v. City of Mayfield Heights*, 765 N.E.2d 345 (Ohio 2002).

that a federal action does not substantially advance a legitimate interest do not state a claim under the Just Compensation Clause, but instead represent either a tort claim or a due process claim. *Bamber v. United States*, 45 Fed. Cl. 162, 165 (Fed. Cl. 1999). To the State's knowledge, no decision of the Court of Federal Claims or the Federal Circuit has ever found a taking based on the "substantially advance" test. *Cf. Seiber v. United States*, 364 F.3d 1356, 1367-68 (Fed. Cir. 2004) (noting uncertainty in the Supreme Court's decisions, but finding it unnecessary to decide whether *Agins* established a distinct takings test).

To compound the confusion, the Ninth Circuit itself, sitting *en banc*, has sharply questioned the propriety of reviewing the wisdom and efficacy of state legislation under the Just Compensation Clause. The Ninth Circuit relied on Justice Kennedy's concurring opinion in *Eastern Enterprises* in observing that the Clause "was never intended to replace the role of the people in determining which social programs are appropriate," and "'has not been understood to be a substantive or absolute limit on the government's power to act.'" *Washington Legal Foundation v. Legal Foundation of Washington*, 271 F.3d 835, 856 (9th Cir. 2001) (*en banc*) (quoting *Eastern Enterprises*, 524 U.S. at 545 (Kennedy, J., concurring in the judgment)), *aff'd sub nom. Brown v. Legal Foundation of Washington*, 123 S.Ct. 1406 (2003).[11]

[11] The Ninth Circuit has gone beyond embracing the "substantially advance" theory under the Just Compensation Clause to rule that property owners challenging property regulation as arbitrary or illegitimate in a constitutional sense *must* bring their claims under the Just Compensation Clause rather than the Due Process Clause. *See, e.g., Macri v. King County*, 126 F.3d 1125, 1129 (9th Cir. 1997). Thus, the Ninth Circuit has taken the position that what is really a due process claim not only *can* be brought under the Just Compensation Clause but *cannot* be brought under the Due Process Clause itself. The majority of other circuits have rejected this position. *See* Robert

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The widespread confusion has prompted calls for the Court to resolve the issue. In *Santa Monica Beach, Ltd. v. Superior Court*, 968 P.2d 993 (Cal. 1999), Justice Kennard explicitly requested this Court to resolve the confusion sown by *Agins*:

> Outside the *Nollan/Dolan* context, should a means-ends test be used to determine whether a taking has occurred, or instead should means-ends testing remain within due process jurisprudence? Only the high court can resolve this question and, given the importance of this area of the law, I respectfully suggest that it do so when the opportunity next arises.

Id. at 1013 (Kennard, J., concurring). Justice Kennard's request was echoed by Justice Brown in dissent. *Id.* at 1047 (Brown, J., dissenting).

II. The Proper Standard Of Review Under The Just Compensation Clause For Challenges To Economic Legislation Is Also An Important Issue On Which Lower Courts Have Divided

A. The Proper Standard Of Review Is An Important Issue

The second issue presented by this case, assuming that means-ends analysis under the Just Compensation Clause is permissible at all, is what standard of review should govern application of this test. This too is an important issue warranting review in this Court because it raises fundamental questions concerning the proper

Ashbrook, *Land Development, the* Graham *Doctrine, and the Extinction of Economic Substantive Due Process*, 150 U. PA. L. REV. 1255 (2002). This additional conflict among the circuits would disappear if this Court were to rule, as the State submits it should, that challenges to the substantive validity of regulation do not belong under the Just Compensation Clause at all.

balance between the judiciary and institutions of democratic governance within our federal system. Since the 1930's, this Court has granted considerable deference to the judgments of legislatures about the need for, or wisdom of, economic regulation. As the Court observed in *Williamson v. Lee Optical*, "The day is gone when this Court uses the Due Process Clause . . . to strike down . . . laws, regulatory of business and industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought." 348 U.S. at 488. The Court has accordingly employed a rational-relationship test for Due Process and Equal Protection Clause challenges to economic laws, upholding legislation that a rational legislator could have believed would advance a permissible public purpose. *Id.* at 487-88. Property regulation, including rent control legislation, has long been considered the kind of economic regulation subject to invalidation only when "arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt." *Pennell v. City of San Jose*, 485 U.S. 1, 11 (1988).

The reluctance of the courts to intrude upon the judgments of legislatures in enacting economic legislation, regardless of the constitutional label attached to the claim, is based on several bedrock principles. First, deferential judicial review reflects the principle that governmental economic policy should generally be determined by democratically elected representatives, rather than unelected judges. *See, e.g., Schweiker v. Wilson*, 450 U.S. 221, 230 (1981) ("[T]his Court properly exercises only a limited review power over Congress, the appropriate representative body through which the public makes democratic choices among alternative solutions to social and economic problems."). Judicial deference also reflects the limited institutional competence of the courts to make predictive judgments concerning the efficacy of economic regulation.

See, e.g., General Motors v. Tracy, 519 U.S. 278, 308-09 (1997) (the Supreme Court is "institutionally unsuited to gather the facts upon which economic predictions can be made, and professionally untrained to make them"; it is consequently "ill-qualified" to develop constitutional doctrine based on such predictive judgments). Finally, within our federal system, deferential review by federal courts of the actions of state legislatures prevents concentration of power in federal hands and helps preserve the states as "laborator[ies]" with freedom to conduct "novel social and economic experiments." *New State Ice Co. v. Liebman*, 285 U.S. 262, 280 (1932) (Brandeis, J., dissenting).

The Ninth Circuit's decision jettisons these principles of deferential review, returning to the kind of close supervision of social and economic policymaking not seen since the end of the *Lochner* era. The Ninth Circuit held that Act 257 must "substantially advance" the public interest, that legislation "substantially advances" an interest if it "bears a reasonable relationship" to that interest, and that "[w]hether Act 257's rent cap is reasonably related to its objective of lowering fuel prices certainly depends on whether it will in fact lead to lower fuel prices." App. 76. This standard affords the judgment of the Hawaii legislature no deference at all. Instead, it instructs the trial court to void the statute if, based upon the court's independent evaluation of testimony about "predictive facts," the court concludes that the Act will not work.

The Ninth Circuit's approach dramatically undermines the protections that this Court has erected against improper judicial interference with legislative policymaking. It also wreaks havoc with constitutional jurisprudence by creating different standards of review for what are in substance identical claims under the Just Compensation and Due Process Clauses. Litigants in the Ninth Circuit, an area comprising one-third of the nation, can now evade the rational-basis scrutiny applicable to due process claims simply by reframing their challenges to economic

legislation as "substantially advance" claims under the Just Compensation Clause.

The potential for "substantially advance" claims under the Just Compensation Clause to sweep away settled principles of judicial review is dramatically illustrated by the contrast between the Ninth Circuit's decision and this Court's decision unanimously upholding a statute remarkably similar to Act 257 against arguments challenging its economic wisdom. In *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978), the Court reviewed due process and other challenges to a Maryland law prohibiting oil companies from operating their own stations within the state. The law was enacted to protect the retail market for gasoline following complaints that oil companies had favored their own stations during gasoline shortages. The oil companies contended that the law would be counterproductive, reducing the number of retail outlets for gasoline in the state and harming consumers. This Court responded in terms that could not be more starkly opposed to the review employed by the Ninth Circuit in this case:

> The evidence presented by the refiners may cast some doubt on the wisdom of the statute, but it is, by now, absolutely clear that the Due Process Clause does not empower the judiciary "to sit as a 'superlegislature to weigh the wisdom of legislation' . . . " *Ferguson v. Skrupa*, 372 U.S. 726, 731 [1963] . . . Appellants argue that [prohibiting company-operated gas stations] is irrational and that it will frustrate rather than further the State's desired goal of enhancing competition. But . . . *this argument rests simply on an evaluation of the economic wisdom of the statute, . . . and cannot override the State's authority "to legislate against what are found to be injurious practices in their internal commercial and business affairs. . . ." . . . Regardless of the ultimate economic efficacy of the statute, we have no hesitancy in concluding that it bears a reasonable relation to the State's*

> *legitimate purpose in controlling the gasoline retail market, and we therefore reject appellants' due process claim.*

Id. at 124-25 (emphasis added; citations omitted). If this claim were brought today before the Ninth Circuit as a takings claim, the State's "authority to legislate against . . . injurious practices" would be given no weight whatsoever, and the statute, like Act 257 in this case, could be struck down as unconstitutional simply because the trial judge rejected the economic theory on which it was based. This Court should grant review to make clear that lower federal courts may not exercise such supervisory power over the merits of state legislation, whether challenged under the Just Compensation Clause or under the Due Process Clause.

B. The Ninth Circuit's Adoption Of A *De Novo* Standard Of Review Conflicts With This Court's Precedents

The intrusive standard of review adopted by the Ninth Circuit cannot be reconciled with this Court's takings decisions. Given the Court's uncertainty concerning the validity of the "substantially advance" formulation, it is not surprising that the Court has spoken only briefly to the standard of review that would govern application of this ostensible test. To the extent the Court has spoken to the issue, however, the Court has clearly ruled that a deferential standard of review must apply, and that the "substantially advance" test cannot be viewed as a judicial license to second-guess the legislature's judgment about the wisdom or effectiveness of a legislative measure.

Agins itself strongly suggests that the Court employed a deferential standard of review. The due process precedents upon which the *Agins* Court relied clearly employed

a highly deferential standard.[12] The *Agins* Court upheld a zoning ordinance as furthering "governmental purposes long . . . recognized as legitimate," 447 U.S. at 261, without any inquiry into whether the ordinance would actually achieve such goals. One year after *Agins,* the Court described the standard in that case in terms indistinguishable from the standard generally applied to government regulation under principles of due process. *Schad v. Borough of Mount Ephraim*, 452 U.S. 61, 68 (1981) ("Where property interests are adversely affected by zoning, the courts generally have emphasized the breadth of municipal power to control land use and have sustained the regulation if it is *rationally related* to legitimate state concerns and does not deprive the owner of economically viable use of his property.") (citing *Agins, Village of Belle Terre,* and *Euclid*) (emphasis added).

The Court's decision in *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987), involving a claim that a Pennsylvania statute regulating mining failed to advance a legitimate purpose, also supports a deferential standard of review. To distinguish the statute at issue from the similar law held to be taking in *Mahon*, the majority in *Keystone* noted that the law reasonably served public purposes. 480 U.S. at 485-86. In dissent, then-Justice Rehnquist noted that it "may well be true" that the act under review better served a public purpose than its predecessor, but stressed that courts should not review the *efficacy* of state legislation in determining whether it

[12] *See Nectow*, 277 U.S. at 187-88 ("[A] court should not set aside the determination of public officers . . . unless it is clear that their action has no foundation in reason and is a mere arbitrary or irrational exercise of power having no substantial relation to the public health, the public morals, the public safety or the public welfare in its proper sense.") (internal quotes omitted); *Euclid*, 272 U.S. at 395 (to declare zoning ordinance unconstitutional, Court must find that provisions "are clearly arbitrary and unreasonable, having no substantial relation to the public health, safety, morals, or general welfare.").

effects a "taking" requiring just compensation, just as they should defer to legislative judgments as to whether a law serves a "public use":

> [O]ur inquiry into legislative purpose is not intended as a license to judge the effectiveness of legislation. When considering the Fifth Amendment issues presented by Hawaii's Land Reform Act [in *Hawaii Housing Auth. v. Midkiff*, 467 U.S. 229 (1984)] we noted that the Act, "like any other, may not be successful in achieving its intended goals. But 'whether *in fact* the provisions will accomplish the objectives is not the question: the [constitutional requirement] is satisfied if . . . the . . . [State] Legislature *rationally could have believed* that the [Act] would promote its objective.'"

Id. (emphases and ellipses in original) (quoting *Midkiff*, 467 U.S. at 242).

In response, the majority agreed that a deferential standard of review should apply, invoking the Court's deferential due process jurisprudence:

> We do not suggest that courts have "a license to judge the effectiveness of legislation," . . . or that courts are to undertake "least restrictive alternative" analysis in deciding whether a state regulatory scheme is designed to remedy a public harm or is instead intended to provide private benefits. That a land use regulation may be somewhat overinclusive or underinclusive is, of course, no justification for rejecting it. *See Euclid v. Ambler Realty Co.* . . . .

Id. at 487 n.16.[13]

[13] The Ninth Circuit dismissed *Keystone*'s relevance, concluding that the Court's reference in that case to the deferential standard of review employed in *Midkiff* was irrelevant because *Midkiff* involved a formal exercise of eminent domain. App. 59. But *Keystone* itself involved a challenge to a regulation under the *Agins* "substantially advance" test, not an exercise of eminent domain.

The idea that a heightened standard of review should nonetheless apply to such claims seems to be attributable to an overly expansive reading of the Court's decision in *Nollan*. In that case, the Court addressed the special problem presented for courts reviewing requirements that landowners grant public access to their property in exchange for regulatory approval of specific development projects. Recognizing that physical occupations cannot ordinarily be forced upon landowners without compensation, the Court held that such exactions must show an "essential nexus" between the conditions imposed and the government's regulatory objectives. 483 U.S. at 837.

Responding to the dissent's concern that such heightened review was inconsistent with the rational-basis scrutiny generally applicable to economic regulations, *id.* at 842-48, the Court observed in a footnote that "there is no reason to believe (and the language of our cases gives some reason to disbelieve) that so long as the regulation of property is at issue the standards for takings challenges, due process challenges, and equal protection challenges are identical. . . ." *Id.* at 835 n.3. This statement is far from a holding that heightened scrutiny in fact applies to all regulatory takings claims, however. As the Court made clear in *Nollan* itself, its invocation of heightened scrutiny came in response to the unique problems posed by exactions:

> We are inclined to be particularly careful about the adjective ["substantial"] where the actual conveyance of property is made a condition to the lifting of a land-use restriction, since in that context there is heightened risk that the purpose is avoidance of the compensation requirement, rather than the stated police-power objective.

Id. at 841.

Subsequent decisions of the Court confirm this narrow reading of *Nollan*. In *Dolan*, the Court expanded upon the

rule established in *Nollan*, requiring that municipalities demonstrate that exactions are "roughly proportional" to a proposed development's impact. The Court emphasized, however, that this requirement applies only to *adjudicatory* decisions involving exactions of real property. *Id.* at 391 n.8. Where a party challenges *generally applicable* legislation, by contrast, "the burden properly rests on the party challenging the regulation to prove that it constitutes an arbitrary regulation of property rights." *Id.* This statement clearly indicates that a different, more deferential standard applies to general legislation than to exactions. Subsequently, in *Del Monte Dunes*, the Court made clear that the special rules applicable to exactions do not apply generally to regulatory takings claims. 526 U.S. at 703. While the specific holding in *Del Monte Dunes* was that the rough proportionality test cannot be applied outside the exactions context, it is implicit in the decision that the type of heightened review applied in *Dolan* and *Nollan* does not apply outside that context either.

The intrusive, *de novo* review applied by the Ninth Circuit in this case conflicts with the Court's unanimous teaching in *Keystone* that the Just Compensation Clause cannot be read as "a license to judge the effectiveness of legislation." This Court should grant review to reaffirm that a highly deferential standard of review governs constitutional challenges to economic legislation.

C. The Ninth Circuit's Application Of *De Novo* Review Conflicts With Decisions Of Another Federal Court Of Appeals And Several State Supreme Courts

The Ninth Circuit's application of heightened scrutiny conflicts with decisions of the First Circuit and the Supreme Courts of California and New York that interpret the *Agins* "substantially advance" formula as preserving traditional legislative discretion. In *South County Sand &*

Gravel Co., Inc. v. Town of South Kingston, 160 F.3d 834 (1st Cir. 1998), the First Circuit concluded that the distinction between the takings and due process modes of analysis "is . . . largely a matter of semantics," *id.* at 836, and held that the "substantial relation" and "rational basis" standards may be used "interchangeably" in reviewing a challenged zoning ordinance. *Id.* at 836 n.3. The court specifically declined to review the "effectiveness of municipal policy," a task the court concluded was "well outside our compass." *Id.* at 839.

In *Santa Monica Beach*, *supra*, the California Supreme Court affirmed the dismissal of a takings challenge to a city rent control law where the plaintiff wished to try to show that the law failed to achieve its goals. The court stated: "In sum, with rent control, as with most other such social and economic legislation, we leave to legislative bodies rather than the courts to evaluate whether the legislation has fallen so far short of its goals as to warrant repeal or amendment." 968 P.2d at 1007. The court also concluded in *Santa Monica Beach* that heightened scrutiny under this Court's *Nollan* and *Dolan* decisions did not apply to a legislative determination. *Id.* at 993. The California Supreme Court reaffirmed that conclusion in *San Remo Hotel v. San Francisco City and County*, 41 P.3d 87 (Cal. 2002), refusing to extend heightened scrutiny to legislation imposing fees on hotel conversions. The different standards applied by the Ninth Circuit and the California courts mean that challenges to state and local regulations in that state will be routinely brought in federal rather than state court.

Similarly, the New York Court of Appeals, in "easily" sustaining a town's zoning amendments, held that the *Agins* means-ends test only requires that land use laws bear a "reasonable relationship" to legitimate objectives, an approach indistinguishable from traditional due process analysis. *Bonnie Briar Syndicate v. Mamaroneck*, 721 N.E.2d 971 (N.Y. 1999). The New York Court of Appeals

rejected the argument that the "essential nexus" requirement of *Nollan* was generally applicable to regulatory takings claims, and refused to evaluate the "general wisdom or desirability" of the challenged regulation. *Id.* at 975-76.

III. This Case Presents A Compelling Opportunity For The Court To Resolve Both Of These Important Issues

Two important, related issues of takings law – whether the means-ends rationality of legislation may properly be reviewed under the Just Compensation Clause, and if so, whether a deferential standard of review must be employed – are squarely raised in this case. The facts clearly frame these questions for the Court's review. Chevron made no claim that it had suffered significant economic injury from the enactment of Act 257; it sought only to use the Just Compensation Clause to invalidate the statute because of disagreement with its economic policy, and did so in deliberate preference to seeking review of the law under due process and equal protection. The trial procedure employed to resolve Chevron's takings claim illuminates the inherent risk of intrusive judicial review posed by the *Agins* test as construed by the Ninth Circuit; the trial judge even tried to weigh the demeanor of the parties' expert witnesses as a factor in determining the constitutionality of the statute. App. 43.

The issues presented for review are not complicated by the presence of collateral issues or procedural defects (as was the case, for example, in *Del Monte Dunes*, where the Court was unable to reach the question of validity of the "substantially advance" test). The Ninth Circuit's decision represents a definitive and final determination of both questions. This case thus presents a narrowly focused

and compelling vehicle for this Court to resolve these important questions of constitutional doctrine.

CONCLUSION

For the reasons stated, the petition for certiorari should be granted.

Respectfully submitted,

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CHEVRON USA, INC., a Pennsylvania Corporation, Plaintiff-Appellee, v. LINDA LINGLE, Governor of the State of Hawaii; MARK J. BENNETT, Attorney General of the State of Hawaii, Defendants-Appellants.

No. 02-15867

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

363 F.3d 846; 2004 U.S. App. LEXIS 6091

November 10, 2003, Argued and Submitted, Honolulu, Hawaii
April 1, 2004, Filed

COUNSEL: Robert G. Dreher, Special Deputy Attorney General, Troutman Sanders LLP, Washington, D.C., for the defendants-appellants.

Craig E. Stewart, Pillsbury Winthrop LLP, San Francisco, California, for the plaintiff-appellee.

JUDGES: Before: Dorothy W. Nelson, Robert R. Beezer, and William A. Fletcher, Circuit Judges. Opinion by Judge Beezer; Dissent by Judge W. Fletcher.

OPINION BY: Robert R. Beezer

OPINION: BEEZER, Circuit Judge:

Hawaii Governor Linda Lingle ("Hawaii") appeals the district court's holding on remand that Section 3(c) of Act 257 of the 1997 Hawaii State Legislature ("Act 257" or "the Act") effects a regulatory taking in violation of the Takings Clause of the Fifth Amendment to the United States Constitution. Chevron USA, Inc. ("Chevron") challenged the Act, which, *inter alia,* proscribes the maximum

rent that oil companies can collect from dealers who lease company-owned service stations.

We have jurisdiction pursuant to 28 U.S.C. § 1331, and we affirm.

I

In response to concerns about the highly concentrated wholesale gasoline market in Hawaii and the resulting high cost of gasoline to consumers, the Hawaii Legislature enacted Act 257 in 1997. Act 257, among other things, regulates the maximum rent an oil company can charge dealers who lease its service stations. More specifically, Act 257 caps the rent that Chevron and other oil companies can collect from lessee-dealers at 15% of the dealer's profit on gasoline sales and 15% of the dealer's gross sales on products other than gasoline, plus a percentage increase equal to any increase the oil company may be required to pay on its ground lease.

Chevron is one of two gasoline refiners and one of six wholesalers in Hawaii. At the retail level, Chevron sells most of its gasoline through company-owned stations, which are leased to independent dealers. Chevron leases 64 service stations to dealers in Hawaii. From 1984 through the end of 1996, Chevron relied on estimated gasoline sales to calculate the rent owed by the lessee-dealers. After determining that the amount of gross rent receipts was not satisfactory, Chevron initiated a new nationwide dealer rental program in January 1997, restructuring the manner in which it calculated lease rates. This program, which the parties agree would be in effect in Hawaii but for Act 257, requires the lessee-dealer to pay a monthly rent, consisting of an escalating percentage of the

dealer's gross margin on actual, rather than estimated, gasoline sales. As noted, Act 257, in contrast, establishes a maximum regulated rent of 15% of gross margin.

Although Chevron maintains that Act 257 prevents it, through rental payments alone, from recovering its rental expenses, it concedes that over the past 20 years, Chevron has never fully recovered its expenses relating to dealer stations from rental income alone. Instead, Chevron relies on its supply contracts to earn a profit. Dealers who choose to rent a station from Chevron must as a condition of their lease agree to purchase from Chevron all the product necessary to satisfy demand at the station for Chevron gasoline. The price is unilaterally set by Chevron.

Both the lease agreement and supply contract permit the lessee-dealer to transfer his or her occupancy rights upon obtaining Chevron's written consent and paying a transfer fee set by Chevron. Act 257 does not prohibit such transfers, nor limit the price at which they can occur.

Chevron moved for partial summary judgment on its claim that Act 257 effects an unconstitutional regulatory taking because it fails to "substantially advance a legitimate state interest." Hawaii responded by filing a cross motion for summary judgment on all of Chevron's claims. The district court resolved the motions in Chevron's favor. *Chevron USA, Inc. v. Cayetano,* 57 F. Supp. 2d 1003, 1014 (D. Haw. 1998).

Hawaii appealed the district court's decision, challenging the standard used to evaluate Chevron's regulatory takings claim and the court's application of that standard. *Chevron USA, Inc. v. Cayetano,* 224 F.3d 1030, 1033 (9th Cir. 2000), *cert. denied,* 532 U.S. 942, 149 L. Ed. 2d 346, 121 S. Ct. 1403 (2001) (*"Chevron I"*). We held that the

district court applied the proper standard, relying primarily on the Supreme Court's opinion in *Yee v. City of Escondido,* 503 U.S. 519, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992), and our opinion in *Richardson v. City and County of Honolulu,* 124 F.3d 1150 (9th Cir. 1997), *cert. denied,* 525 U.S. 871, 142 L. Ed. 2d 137, 119 S. Ct. 168 (1998). *Id.* These cases teach that application of the "substantially advances" test is appropriate where a rent control ordinance creates the possibility that an incumbent lessee will be able to capture the value of the decreased rent in the form of a premium. We observed that genuine issues of material fact remained as to whether Act 257 failed to substantially advance its purpose of lowering retail gasoline prices, thus effecting a regulatory taking. *Id.* at 1042 ("[A] challenged regulatory action substantially advances its interest if it bears a reasonable relationship to that interest."). We vacated the district court's decision and remanded for "additional factual development and cross-examination of the parties' witnesses" on issues, including whether lessee-dealers will capture a premium based on the increased value of their leaseholds and whether oil companies will compensate for Act 257 by increasing wholesale prices. *Id.* at 1039, 1042.

In a petition for rehearing, Hawaii asserted for the first time that Chevron's challenge to Act 257 should be analyzed under the Due Process Clause, not the Takings Clause. We denied Hawaii's petition for rehearing; the Supreme Court subsequently denied Hawaii's petition for certiorari.

On remand, the district court considered the parties' stipulations of fact and the testimony of expert witnesses. The district court held that Act 257 was unconstitutional and issued written findings of fact and conclusions of law.

Chevron USA, Inc. v. Cayetano, 198 F. Supp. 2d 1182 (D. Haw. 2002). The court made a fact finding that rather than decreasing the retail price of gasoline in Hawaii, Act 257 would cause prices to increase. *Id.* at 1192.

On appeal, Hawaii argues that: (1) the district court should have analyzed Chevron's claim under the Due Process Clause rather than the Takings Clause; (2) the court misapplied the requirement that Act 257 "substantially advance a legitimate state interest"; and (3) even if the district court's application of the law was correct, it clearly erred in finding that Act 257 does not, in fact, substantially advance Hawaii's interest in reducing retail gasoline prices.

II

The first two of Hawaii's arguments are barred as law of the case. The law of the case doctrine provides that "the decision of an appellate court on a legal issue must be followed in all subsequent proceedings in the same case." *Bernhardt v. Los Angeles County,* 339 F.3d 920, 924 (9th Cir. 2003) (citation omitted). The doctrine applies to our "explicit decisions as well as those issues decided by necessary implication." *Id.* It is a discretionary doctrine with three recognized exceptions: (1) the earlier decision is clearly erroneous and its enforcement would work a manifest injustice;[1] (2) intervening controlling authority

[1] We have on separate occasions recognized two distinct formulations of this first exception. In *Jeffries v. Wood,* we stated that a panel may depart from law of the case if the previous decision "is clearly erroneous *and* its enforcement would work a manifest injustice." 114 F.3d 1484, 1489 (9th Cir.) (*en banc*) (emphasis added), *cert. denied,* 522

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makes reconsideration appropriate; or (3) substantially different evidence was adduced at a subsequent trial. *In re Rainbow Magazine, Inc.*, 77 F.3d 278, 281 (9th Cir. 1996). Only the first two exceptions potentially apply to Hawaii's arguments.

A. *Chevron I* Bars Hawaii's Argument that Chevron Must Challenge Act 257 Under the Due Process Clause

Hawaii first argues that Chevron's challenge to Hawaii's rent control ordinance properly lies under the Due Process Clause of the Fourteenth Amendment to the United States Constitution, not the Takings Clause of the Fifth Amendment. Hawaii maintains that claims challenging the validity of a government action based on its failure to "substantially advance a legitimate government interest" must be resolved using due process principles.

We explicitly addressed and rejected this argument when it was raised for the first time in Hawaii's petition for rehearing, and implicitly did so in *Chevron I* when we endorsed the "substantially advances" test over the more deferential test urged by Hawaii. *See* 224 F.3d at 1033, 1035. In its prior appeal, Hawaii maintained that the

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U.S. 1008, 139 L. Ed. 2d 423, 118 S. Ct. 586 (1997). In other cases, including some subsequent to *Jeffries*, we have stated the test in the disjunctive, allowing departure if the prior decision is clearly erroneous *or* would work a manifest injustice. *See, e.g., Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg. Planning Agency*, 216 F.3d 764, 787 n.3 (9th Cir. 2000) (citing cases), *aff'd*, 535 U.S. 302, 122 S. Ct. 1465, 152 L. Ed. 2d 517 (2002). We need not resolve this issue, however, because Hawaii is unable to satisfy either test.

appropriate inquiry was whether "the Legislature *rationally* could have believed the Act would substantially advance a legitimate purpose," the test typically applied to substantive due process challenges to economic legislation. *Id.* at 1033 (emphasis added). Our conclusion that this more deferential, due process standard does not apply to regulatory takings claims challenging land use regulations, including rent control ordinances like Act 257, logically stands as a rejection of Hawaii's current argument that such a challenge *must* be brought under the Due Process Clause. *See id.* at 1033, 1034 (explaining that in *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 242, 81 L. Ed. 2d 186, 104 S. Ct. 2321 (1984), the Court applied the more deferential test only because it involved claims of an actual physical taking). This is also consistent with our opinion's refusal to accept the concurring opinion's argument that the Supreme Court established such a rule in *Pennell v. City of San Jose*, 485 U.S. 1, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988). *Id.* at 1034-35 (concluding that *Pennell* "did not . . . intimate in any way that rent control provisions should *only* be analyzed under the Due Process Clause. Rather, the Court determined that the Takings Clause claim was premature and then analyzed the Due Process Clause claim under the Due Process 'reasonableness' test") (emphasis added).

The law of the case doctrine therefore bars Hawaii's argument unless one of the recognized exceptions applies.

Hawaii relies primarily on the Supreme Court's opinion in *Eastern Enterprises v. Apfel*, 524 U.S. 498, 141 L. Ed. 2d 451, 118 S. Ct. 2131 (1998) to argue that our decision in *Chevron I* was clearly erroneous and will work a manifest injustice. In *Eastern Enterprises*, the Supreme Court holds that the Coal Industry Retiree Health Benefit

Act (the "Coal Act"), which requires coal operators to fund health benefits for retired employees and their dependents, is unconstitutional. 524 U.S. at 508 (plurality opinion). An operator challenges the law on both due process and takings grounds. *Id.* at 503-04. Four Justices conclude that the Coal Act violates the Takings Clause because it imposes severe, unanticipated retroactive liability on the operator and do not proceed to address the operator's due process claim. *Id.* at 528-29 (O'Connor, J., joined by Rehnquist, C.J., Scalia & Thomas, JJ.). Justice Kennedy concurs in the plurality's judgment but disagrees with the court's analysis; he concludes that the Coal Act violates the Due Process Clause, not the Takings Clause. *Id.* at 539-49 (Kennedy, J., concurring in the judgment, dissenting in part). The four remaining Justices dissent, concluding that the Act violates neither the Takings Clause nor the Due Process Clause. *Id.* at 551-53 (Stevens, J., dissenting, joined by Souter, Ginsberg & Breyer, JJ.), 553-68 (Breyer, J., dissenting, joined by, Stevens, Souter & Ginsberg, JJ.).

As an initial matter, *Eastern Enterprises* does not involve the type of regulatory takings claim at issue here. The Supreme Court applies the test set forth in *Penn Central Transportation Co. v. City of New York,* 438 U.S. 104, 57 L. Ed. 2d 631, 98 S. Ct. 2646 (1978), which focuses on the economic impact of a challenged law, not the "substantially advances" test. *Eastern Enterprises,* 524 U.S. at 529-37. Furthermore, the disagreement between the plurality and the other five Justices over whether the challenge to the Coal Act is properly viewed as a due process or takings claim focuses on the following limited question, inapplicable to this case: Whether a regulatory takings claim requires that the challenged regulation

affect a "specific property right or interest." 524 U.S. at 540, 541-47 (Kennedy, J., concurring in the judgment, dissenting in part) (observing that the Takings Clause is inappropriate because the Coal Act "does not operate upon or alter an identified property interest, and it is not applicable to or measured by a property interest"). The plurality endorses a more expansive view encompassing government regulations, like the Coal Act, that result in a "considerable financial burden," 524 U.S. at 529; the other five Justices would limit the regulatory takings doctrine to laws affecting a protected property interest. *Id.* at 540-47 (Kennedy, J., concurring in the judgment, dissenting in part); 554 (Breyer, J., dissenting).

Largely ignoring this issue, Hawaii relies in part on the following statement in Justice Kennedy's opinion to support its argument that a majority of the Supreme Court has repudiated "substantially advances" takings claims:

> The imprecision of our regulatory takings doctrine does open the door to normative considerations about the wisdom of government decisions. *See, e.g., Agins v. City of Tiburon* [cite omitted] (zoning constitutes a taking if it does not "substantially advance legitimate state interests"). This sort of analysis is in uneasy tension with our basic understanding of the Takings Clause, which has not been understood to be a substantive or absolute limit on the government's power to act.

524 U.S. at 545. Justice Kennedy's statement is in the context of a dispute over the proper scope of the regulatory takings doctrine. Indeed, it is immediately preceded by the

following: "If the plurality is adopting its novel and expansive concept of a taking in order to avoid making a normative judgment about the Coal Act, it fails in the attempt; for it must make the normative judgment in all events." *Id.* (citations omitted). Justice Kennedy is merely highlighting the already expansive and inconsistent nature of the Court's precedent. *See id.* at 545. Neither Justice Kennedy nor any of the other Justices expresses the opinion that takings claims based on the "substantially advances" theory are no longer valid.

The varying opinions in *Eastern Enterprises* suggest confusion over the relationship between due process and takings claims. They do not require us to abandon our holding in *Chevron I,* let alone render it clearly erroneous. *See, e.g., Assoc. of Bituminous Contractors, Inc. v. Apfel,* 332 U.S. App. D.C. 218, 156 F.3d 1246, 1254-55 (D.C. Cir. 1998) (concluding that the inability of a majority of the Court to agree on a single rationale for the result renders *Eastern Enterprises* of no precedential value outside of the specific facts of that case).[2]

[2] Hawaii cites to opinions of our sister circuits for the proposition that conclusions of the five-Justice majority in *Eastern Enterprises* are binding statements of law. Although this is true, the conclusion those courts are referring to is that a regulatory takings claim must involve a specific property interest. They do not purport to comment on the continued viability of "substantially advances" takings claims. *See, e.g., Commonwealth Edison Co. v. United States,* 271 F.3d 1327, 1339 (Fed. Cir. 2001) (*en banc*) ("Thus five justices . . . in *Eastern Enterprises* agreed that regulatory actions requiring the payment of money are not takings."), *cert. denied,* 535 U.S. 1096, 152 L. Ed. 2d 1051, 122 S. Ct. 2293 (2002); *Holland v. Big River Minerals Corp.,* 181 F.3d 597, 606 (4th Cir. 1999) (noting that the five Justices viewed the dispute under Due Process Clause rather than the Takings Clause "because no

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Supreme Court opinions filed after *Eastern Enterprises* do not stand as a repudiation of regulatory takings claims based on the "substantially advances" theory. *See Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency,* 535 U.S. 302, 152 L. Ed. 2d 517, 122 S. Ct. 1465 (2002); *City of Monterey v. Del Monte Dunes,* 526 U.S. 687, 143 L. Ed. 2d 882, 119 S. Ct. 1624 (1999). In *Del Monte Dunes,* the Supreme Court upholds a jury verdict against the City of Monterey on a regulatory takings claim that includes the theory that the city's repeated rejection of a development plan does not "substantially advance a legitimate government interest." 526 U.S. at 700-01, 721. The Court granted certiorari to address the question whether "the Court of Appeals impermissibly based its decision on a standard that allowed the jury to reweigh the reasonableness of the city's land use decision." *Id.* at 701. Although the Court does not directly address the propriety of the "substantially advances" test because the city failed to object to its inclusion in the court's jury instructions, *id.* at 704 (Scalia, J., concurring), the opinion of the Court states that "the trial court's instructions *are consistent with our previous general discussions of regulatory takings liability.*" *Id.* (emphasis added). In *Tahoe-Sierra Preservation Council, Inc.,* the Court addresses a regulatory takings claim brought by an association of landowners based on a planning agency's temporary moratorium on development. The Court limits its review to the theory argued by the association in the court of appeals but notes that "considerations of fairness and

identifiable property interest was infringed by the legislation"), *cert. denied,* 528 U.S. 1117, 145 L. Ed. 2d 814, 120 S. Ct. 936 (2000).

justice" could support a regulatory taking under several theories, including "that the moratoria *did not substantially advance a legitimate state interest.*" 535 U.S. at 334 (emphasis added). Although dicta, the statement clearly indicates that "substantially advances" claims remain viable under the Takings Clause.

Our opinions are consistent with Supreme Court teaching. The Takings Clause supercedes any substantive due process challenges when a law is challenged as a regulatory taking. *See Armendariz v. Penman,* 75 F.3d 1311, 1324 (9th Cir. 1996); *see also Esplanade Props., LLC v. City of Seattle,* 307 F.3d 978, 982 (9th Cir. 2002) (rejecting a claim that *Eastern Enterprises* overruled *Armendariz*); *Weinberg v. Whatcom County,* 241 F.3d 746, 749 n.1 (9th Cir. 2001) (applying *Armendariz*); *Buckles v. King County,* 191 F.3d 1127, 1137 (9th Cir. 1999) (same). We recently applied the "substantially advances" test to a regulatory takings claim in *Hotel & Motel Association of Oakland, et al. v. City of Oakland,* 344 F.3d 959, 965 (9th Cir. Sept. 17, 2003) (asking whether city maintenance and habitability requirements substantially advance a legitimate government interest).

Hawaii cites no case post-dating *Chevron I* that brings our use of the Takings Clause in that case into doubt. *See Rainbow Magazine, Inc.,* 77 F.3d at 281. To the contrary, subsequent opinions of the Supreme Court and this circuit support *Chevron I. See, e.g., Tahoe-Sierra Pres. Council, Inc.,* 535 U.S. at 334; *Esplanade Properties, LLC,* 307 F.3d at 982.

Hawaii's reliance on *Brown v. Legal Foundation of Washington,* 538 U.S. 216, 123 S. Ct. 1406, 155 L. Ed. 2d 376 (2003), which affirms *Washington Legal Foundation v.*

Legal Foundation of Washington, 271 F.3d 835 (9th Cir. 2001) (*en banc*), is misplaced. *Brown* involves, *inter alia,* the question whether a law requiring lawyers' client funds to be deposited into an interest bearing trust account is properly analyzed as a regulatory or *per se* taking. 123 S. Ct. at 1417-19; *see also Washington Legal Foundation,* 271 F.3d at 854-56. The Supreme Court has no reason to address regulatory takings based on a "substantially advances" theory or the question whether such claims should be brought under the Takings Clause or the Due Process Clause.

The law of the case doctrine now bars Hawaii's argument that Chevron's challenge properly lies under the Due Process Clause. We previously addressed Hawaii's argument in *Chevron I* and none of the exceptions to the doctrine are available to Hawaii.

B. *Chevron I* Bars Hawaii's Argument That Act 257 Should Be Reviewed Under a More Deferential Standard

Hawaii next argues that we erred in *Chevron I* by concluding that a given regulation "substantially advances" a legitimate state interest if it bears a "reasonable relationship" to that interest and by instructing that Chevron can establish the lack of such a relationship by showing, by a preponderance of the evidence, that the regulation will not in fact accomplish its stated purpose. Hawaii maintains that even if Chevron's challenge to Act 257 is viewed as a claim under the Takings Clause, the more deferential, rational basis test applied in due process cases is appropriate – *i.e.,* whether Hawaii *rationally could have believed* that Act 257 could have substantially advanced a legitimate government purpose. We explicitly

rejected these arguments as part of Hawaii's prior appeal, 224 F.3d at 1037; Hawaii has not justified departing from the law of the case.

In *Chevron I* we hold that the "substantially advances" test requires a "reasonable relationship" between a legitimate public purpose and the means used to effectuate that purpose. *Id.* at 1041 (citing and quoting from *Del Monte Dunes,* 526 U.S. at 700-01, 702-03). Our adoption of the "reasonable relationship," as well as the preponderance of the evidence standard, is based on the jury instructions the Supreme Court approves in *Del Monte Dunes.* 224 F.3d at 1041 (quoting instructions). This "reasonable relationship" test calls for an intermediate level of review, more stringent than the rational basis test used in the due process context, *see id.* at 1034 (distinguishing physical takings cases, which use a test drawn from due process), but less stringent than the "rough proportionality" test used in the context of exactions under the Takings Clause. *Id.* at 1041 (citing *Del Monte Dunes,* 526 U.S. at 703-04 as limiting the "rough proportionality" test to exaction context but commenting positively on jury instruction using "reasonable relationship" language); *see also Dolan v. City of Tigard,* 512 U.S. 374, 390, 129 L. Ed. 2d 304 (1994) (stating that the "reasonable relationship" test represents an intermediate level of scrutiny). Hawaii's argument that our decision in *Chevron I* is clearly erroneous is without merit.

The Supreme Court specifically rejects the standard proposed by Hawaii. *Nollan v. California Coastal Comm'n,* 483 U.S. 825, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987). *Nollan* is an exactions case in which the Court states that "[w]e have required that the regulation substantially advance the legitimate state interest sought to be achieved

[citing Agins], not that the State could rationally have decided that the measure adopted might achieve the State's objective." 483 U.S. at 825 n.3 (internal quotations omitted). In *Yee v. City of Escondido,* the Supreme Court suggests that this intermediate analysis is applicable to challenges involving rent control ordinances, like Hawaii's, that permit the capture of a premium. 503 U.S. 519, 530, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992). Although the Court in *Yee* does not reach the regulatory takings issue because it is not properly presented for review, the Court does state that the possibility of a premium, "might have some bearing on whether the ordinance causes a regulatory taking" because it may shed light on whether there is a sufficient nexus between the desired ends and the means employed. *Id.* (citing *Nollan*). Relying on this language, we hold in *Richardson v. City and County of Honolulu* that land use regulations, including rent control ordinances that permit the capture of a premium, "[do] not effect a regulatory taking if [they] substantially further[ ] a legitimate state interest." 124 F.3d at 1164 (citing and quoting from *Yee*).

We explain in *Chevron I* that Hawaii's reliance on *Hawaii Housing Authority v. Midkiff,* 467 U.S. 229, 81 L. Ed. 2d 186, 104 S. Ct. 2321 (1984) and *Keystone Bituminous Coal Ass'n v. De Benedictis,* 480 U.S. 470, 94 L. Ed. 2d 472, 107 S. Ct. 1232 (1987), as support for using the more deferential rational basis review, is misplaced. The Supreme Court reviews the challenged actions in those cases more deferentially because they involve physical takings. *Chevron I,* 224 F.3d at 1034 (observing that in the case of a physical taking the government "intends to take the property and is willing to pay compensation") (citing

Richardson, 124 F.3d at 1158). Hawaii presents no compelling reasons to rely on those opinions now. Moreover, Hawaii misses the fact that we incorporate this more deferential approach in the regulatory takings context when we review the state's "legitimate purpose"; the higher scrutiny is reserved for the means/ends fit.

Hawaii's argument that we apply a more deferential standard in *Commercial Builders of Northern California v. City of Sacramento,* 941 F.2d 872 (9th Cir. 1991), is also misplaced. In *Commercial Builders,* we apply the intermediate "rational relationship" test. *Id.* at 873. Our holding that a regulatory taking does not exist is based on evidence that "the Ordinance was implemented only after a detailed study revealed a *substantial connection between development and the problem to be addressed.*" *Id.* at 875 (emphasis added); *cf. id.* at 877 (Beezer, J., dissenting) ("Sacramento has commissioned a study that demonstrates at best a tenuous and theoretical connection between commercial development and housing needs."). Plaintiffs in *Commercial Builders* were unable to "rebut the Keyser-Marston conclusion that commercial development is related to an increase in the need for low-income housing." *Id.* at 876. In contrast, we held Chevron's claim fit for trial because the plaintiff on summary judgment adduced some evidence rebutting the state's evidence and conclusions. The question now is whether that evidence is sufficient to justify the trial court's judgment in this case. Hawaii fails to establish that our application of the "reasonable relationship" test or the preponderance of the evidence standard constitutes clear error.

Hawaii also fails to point to any intervening authority that prohibits *Chevron I's* use of the "reasonable relationship" test or preponderance of the evidence standard. The law of the case doctrine bars Hawaii's arguments.[3]

III

Hawaii argues that even if the district court applied the correct legal standard, it erred in concluding that Act 257 does not in fact substantially advance a legitimate state interest. The district court on remand heard testimony from Dr. John R. Umbeck, on behalf of Chevron, and Dr. Keith Leffler, on behalf of Hawaii. Based on their testimony, the court made the following relevant findings of fact: (1) oil companies will raise wholesale prices to offset any decrease in rent imposed by Act 257, thereby causing an *increase* in retail prices, *Chevron USA, Inc.,* 198 F. Supp. 2d at 1187; (2) a preponderance of the evidence establishes that Act 257 will enable lessee-dealers to sell their leaseholds at a premium, *id.* at 1189-90; (3) instead of decreasing retail gasoline prices by maintaining the presence of lessee-dealers in the market, Act 257 will *increase* gasoline prices by reducing the number of lessee-dealers, *id.* at 1190-91. Based on these findings, the district court concluded that Act 257 does not substantially advance a legitimate state interest. *Id.* at 1192.

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[3] Because Hawaii's arguments are barred by the law of the case doctrine, we need not address whether the State is also barred by the law of the circuit doctrine and whether, if they are, the latter should supplant the former. *See Jeffries,* 114 F.3d at 1511 n.16 (Kosinski, J., dissenting).

We review the district court's findings of fact for clear error. *Stratosphere Litigation LLC v. Grand Casinos, Inc.*, 298 F.3d 1137, 1142 (9th Cir. 2002). We review the district court's conclusions of law *de novo*. *Id.*

Hawaii does not challenge the district court's conclusion of law that Act 257 fails to advance Hawaii's goal of lowering retail gas prices, *see Chevron USA, Inc.*, 198 F. Supp. 2d at 1189, 1192-93; it focuses instead on whether Act 257 advances another purported purpose – namely, maintaining the existence of an independent body of gas station operators by preventing oil companies from raising rents to levels that would drive lessee-dealers out of business. The contention that Hawaii passed Act 257 to promote the viability of lessee-dealers for their own sake without regard to retail prices is inconsistent with the express views of the Hawaii Legislature in enacting Act 257. The Act's legislative findings and declarations state that:

> Because Hawaii is physically small and a geographically remote economy, certain of its markets tend to be concentrated. . . . In a highly competitive market, market prices tend to rise above competitive levels. *Market prices persistently above competitive levels are harmful to consumers and the public.*

(Emphasis added.) Act 257 failed to include a similar statement of legislative intent expressing a concern for lessee-dealers. Hawaii's current argument is also inconsistent with its position throughout this litigation and the testimony of its expert. The district court found that "while the legislature was mindful of the need to protect lessee dealers, this consideration was essentially a step toward the ultimate goal of reducing gasoline prices for

Hawaii consumers." *Chevron USA, Inc.*, 57 F. Supp. 2d at 1010. We accepted this characterization in *Chevron I* when we stated that "the district court found the purpose of Act 257 is to 'reduce gasoline prices for Hawaii's consumers'" and that "on appeal, the parties *do not contest this finding*." 224 F.3d at 1033 n.3 (emphasis added). Our prior opinion observes that whether Act 257 substantially advances its purpose "certainly depends on whether it will in fact lead to lower prices." *Id.* at 1041. Hawaii's expert, Dr. Keith Leffler, himself acknowledged the legislative connection between protecting lessee-dealers and the ultimate goal of lowering retail prices in his testimony before the district court: "The lease rent cap imposed by Act 257 is likely to lessen the adverse competitive effects that result from the highly concentrated gasoline markets in Hawaii by maintaining the viability of independent dealers and thereby benefit consumers by reducing gasoline prices below what they would be otherwise." The district court properly viewed Hawaii's concern over maintaining a network of independent lessee-dealers as a means to reducing retail gas prices, not an end in itself.

The district court analyzed the efficacy of maintaining independent lessee-dealers in the context of Hawaii's purpose for enacting the Act and found that Act 257 did not substantially advance Hawaii's interest in lower retail gas prices. Relying on the declaration and trial testimony of Dr. Leffler, the court found that Act 257 actually penalizes oil companies for maintaining lessee-dealer stations, stating that in the long term "there will ultimately be fewer lessee-dealer stations than there would be without Act 257" as oil companies decide where and what type of distribution avenues in which to invest. *Chevron USA, Inc.*, 198 F. Supp. 2d at 1191.

Although the court observed that Act 257 does "preclude[] oil companies from raising rents to levels designed to drive lessee-dealers out of business," *id.* at 1191, it found that "there is no evidence that, but for Act 257, Chevron or any other oil company would try to drive its lessee-dealers out of business in Hawaii by charging excessive rent." *Id.* (citing the trial testimony of Dr. Leffler that at the time Act 257 went into effect, Chevron charged relatively low rental prices). Hawaii maintains that this statement indicates that the district court improperly substituted its judgment for that of the legislature on the question whether the legislature's goal in enacting Act 257 was legitimate. Hawaii is correct that the "substantially advances" test reserves its heightened scrutiny for the state's purported means, not its goal. Clearly, the preservation of lessee-dealers was not the legislature's ultimate goal. The court's scrutiny was appropriate.

Based on the testimony of the parties' experts, the district court also made findings with respect to two factual questions we directed be resolved on remand – the effect of Act 257 on wholesale prices and the possibility that lessee-dealers will capture a premium. *Chevron I,* 224 F.3d at 1042. The district court found that the oil companies will offset the impact of Act 257 in part by increasing wholesale prices, which in turn will cause an increase in retail prices. *Chevron USA, Inc.,* 198 F. Supp. 2d at 1187-88. On this point, the court was persuaded by the testimony of Dr. Umbeck who testified that oil company pricing involves a search for the optimal balance between various revenue streams; a reduction in rental income, therefore, would necessarily effect how Chevron sets its wholesale prices. *Id.* The district court discounted the contrary opinion of Dr. Leffler that Act 257 would not

cause Chevron to increase wholesale prices because prices were already maximized. *Id.*

Regarding premiums, the court found that Chevron established by a preponderance of the evidence that the reduced rent mandated by the Act will not flow to consumers in the form of reduced retail prices but instead will allow lessee-dealers to capture a premium on their leaseholds. *Id.* at 1189-90. The parties stipulated that all other factors remaining constant, Act 257 would likely cause the market value of lessee-dealer leaseholds to increase. At trial, moreover, the parties' experts agreed that the lessee-dealers alone would realize any such increase; it would not be passed on to consumers in the form of lower retail prices. Because the court credited Dr. Umbeck's testimony that Chevron's increase in wholesale prices as a result of Act 257 would only partially offset the decrease in its rental income, the court concluded that the remaining amount will inure to lessee-dealers as a premium on the value of their leaseholds. *Id.* at 1189-90. In so finding, the court adopted Dr. Umbeck's view of the relevant economic market over the view of Dr. Leffler. *Id.*

Based on all the evidence adduced at trial, the district court concluded that Act 257 will not substantially advance a reduction in the retail price of gasoline. The court's factual findings and conclusions of law are consistent with the views of the parties' experts and are not clearly erroneous.

IV

It is argued that our application of the "substantially advances" test to the facts of this case improperly interprets the Supreme Court's decision in *Yee v. City of Escondido,*

503 U.S. 519, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992). The argument maintains that even assuming *Yee* permits application of the substantially advances test to a rent control ordinance where there is only the possibility of a premium, as this court did in *Richardson* and *Chevron I*,[4] the test is inapplicable here where the testimony is that "in all likelihood," a premium will not exist.[5]

The argument relies on excerpts from the following colloquy between the court and Chevron's expert, Dr. Umbert, as support for the proposition that there is "probably no premium" created by Act 257:

> THE WITNESS: [Chevron] would try to raise the wholesale price to recoup as much of the lost rent as they could. . . . At the stations where they raise the price those stations will have a reduction in volume of gasoline they sell if the dealer raises his retail prices. . . .

[4] A concurrence in *Chevron I* argues that our holding that the substantially advances test applies when there exists only the possibility of a premium goes beyond our opinion in *Richardson*, which relies on *Yee*. *Compare* 224 F.3d 1030, 1035, *cert denied*, 532 U.S. 942, 149 L. Ed. 2d 346, 121 S. Ct. 1403 (2001), *with id.* at 1042 (W. Fletcher, J., concurring in the judgment).

[5] Implicit in this argument is the notion that the level of scrutiny we apply to rent control ordinances should be fluid throughout the course of the proceedings. That is, on a motion to dismiss or a motion for summary judgment where factual questions remain regarding the existence of a premium, we should apply the substantially advances test. But the standard we apply after experts have testified on the premium issue should depend upon the substance of that testimony – if there is the possibility of a premium, we should apply the substantially advances test; if not, we should apply the rational basis test. There is not precedent for such an approach.

> THE COURT: Then, if the offset is not total, mightn't consumers in deed [sic] benefit from Act 257 because, if the increase in the wholesale price is less than the decrease in rent, then the lessee dealer's overall cost would go down.
>
> THE WITNESS: No, no. The dealers overall revenues are going to fall because he's going to be selling gasoline. . . . Even if the oil company doesn't recover all of the rent reduction, that does not mean the dealer is going to benefit because the whole revenue stream is smaller. In fact, in all likelihood both the dealer would lose and the oil company would lose.
>
> . . .
>
> The reduction in rent by itself – let's suppose the oil companies do not raise their DTW for a second and they just lower rent to the dealer. There is no reason in our economic theory to believe that the retail prices would fall. That is, the dealer would just pocket the difference.
>
> THE COURT: Why is that?
>
> . . .
>
> THE WITNESS: It's actually an opinion shared by Dr. Leffler and myself and all economics text books. And that is that a fixed commitment to pay dollars each month in the form of rent does not affect the decision on how much gasoline to sell or what price to charge at the retail pump. But, when wholesale price goes up, then the incentive for the dealer to reduce his volume in order to save some of these variable costs will lead him to raise prices.

The opinion shared by the experts was not that lessee-dealers will fail to benefit as a result of Act 257; rather, Dr. Umbreck was explaining the widely-held belief that, all things remaining equal, any reduction in rental (fixed) costs realized by the dealers would not be passed on to consumers in the form of reduced retail prices. Hawaii's counsel made this clear during closing argument when he did not deny that lessee-dealers may capture a premium: "While it is true that incumbent dealers could try to charge a premium and a prospective purchaser could agree to pay that premium, . . . we do not believe that it will have any impact on the retail price of gasoline simply because the rent gap permits lessee-dealers to stay in business longer, increasing competition and lowering prices."

Furthermore, Dr. Umbreck's testimony that "in all likelihood" lessee-dealers will not benefit under Act 257 was based on an uncertain assumption about market behavior. Specifically, that Chevron's increase in wholesale prices and the resulting drop in sales would combine for a loss to lessee-dealers that is greater than the benefit realized by the reduced rent. Neither expert testified that this would necessarily occur. Indeed, in its opinion, the district court stated that "implicit in Prof. Umbreck's opinion [that Chevron would raise wholesale gasoline prices] is the assumption that Chevron will risk a drop in sales volume in the hope that it will be outweighed by the increase in wholesale price." *Chevron U.S.A. Inc.*, 198 F. Supp. 2d at 1189. That same uncertainty about market reaction accounts for the possibility that lessee-dealers will retain a *benefit* from the reduced rent, *i.e.*, a premium.

AFFIRMED

DISSENT BY: William A. Fletcher

DISSENT: W. FLETCHER, Circuit Judge, dissenting:

At issue in this case is the constitutionality of Hawai'i's Act 257, which controls the rent an oil company can charge its dealer/lessees. There are two different constitutional tests that could conceivably apply to Act 257. The first is the "reasonableness" test ordinarily applied to rent and price control statutes. *See, e.g., Pennell v. City of San Jose,* 485 U.S. 1, 11, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988) (upholding a rent control ordinance because it was not "arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt") (quoting *Permian Basin Area Rate Cases,* 390 U.S. 747, 769-70, 20 L. Ed. 2d 312, 88 S. Ct. 1344 (1968)). The second is the "substantially advances a legitimate state interest" test ordinarily applied to zoning and other land use regulations. *See, e.g., Agins v. City of Tiburon,* 447 U.S. 255, 261, 65 L. Ed. 2d 106, 100 S. Ct. 2138 (1980) (upholding a zoning ordinance because it "substantially advanced legitimate governmental goals"); *Dolan v. City of Tigard,* 512 U.S. 374, 129 L. Ed. 2d 304, 114 S. Ct. 2309 (1994); *Nollan v. California Coastal Comm'n,* 483 U.S. 825, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987).

In *Richardson v. City and County of Honolulu,* 124 F.3d 1150 (9th Cir. 1997), we applied the "substantially advances" test to invalidate a rent control ordinance in which the tenant was able to capture a "premium" resulting from the ordinance. In an earlier appeal in this case, *Chevron USA, Inc. v. Cayetano* (*Chevron I*), 224 F.3d 1030, 1035 (9th Cir. 2000), this panel went beyond *Richardson,* holding that the "substantially advances" test must be applied to Act 257 because of the "stipulated

possibility that [a dealer/lessee] will be able to capture the value of the decreased rent in the form of a premium." That "possibility," in the view of the panel, "separated Act 257 from an ordinary rent control situation" in which the "reasonableness" test would be applied. *Id.* I disagreed with the majority's analysis in *Chevron I,* believing that the panel misunderstood Supreme Court case law applicable to rent control and therefore applied the wrong test. *Id.* at 1042 (W. Fletcher, J., concurring in the judgment).

In *Chevron I,* we remanded to the district court to apply the "substantially related" test to Act 257. After a hearing on remand, at which the only evidence presented was the opinion of one expert per side, the district court held that Act 257 did not satisfy the "substantially related" test. It concluded, "Act 257 effects an unconstitutional regulatory taking given its failure to substantially advance any legitimate state interest." *Chevron USA, Inc. v. Cayetano,* 198 F. Supp. 2d 1182, 1193 (D. Haw. 2002).

If "substantially advances a legitimate state interest" were the proper test to apply to Act 257, I would vote to affirm the district court. The evidence put on by the State's expert in support of Act 257 was sufficiently weak, and the countervailing evidence put on by Chevron's expert was sufficiently strong, that the district court did not err in concluding that this test was not satisfied. My problem is thus not with the manner in which the "substantially advances" test has been applied in this case. Rather, it is with the application of the test in the first place.

As I discussed in my concurrence in *Chevron I,* the only possible basis for the application of the "substantially

advances" test to a rent control statute is dictum in *Yee v. City of Escondido,* 503 U.S. 519, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992), in which the Supreme Court upheld a mobile home rent control ordinance against a physical takings challenge. The Court refused to consider whether the ordinance constituted a regulatory taking because that question had not been included in the grant of certiorari, but it briefly distinguished between physical and regulatory takings. It wrote:

> The effect of the rent control ordinance, coupled with the restrictions on the park owner's freedom to reject new tenants, is to increase significantly the value of the mobile home. This increased value normally benefits only the tenant in possession at the time the rent control is imposed. . . . Petitioners are correct in citing the existence of this premium as a difference between the alleged effect of the Escondido ordinance and that of an ordinary apartment rent control statute. . . . Petitioners contend that the Escondido ordinance transfers wealth only to the incumbent mobile home owner. This effect might have some bearing on whether the ordinance causes a *regulatory* taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance. *See Nollan v. California Coastal Comm'n*[, 483 U.S. 825, 834-35, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987)]. But it has nothing to do with whether the ordinance causes a *physical* taking.

Id. at 530.

It is undisputed that Chevron has the capacity to increase the wholesale price of gasoline to its dealer/

lessees who benefit from rent control under Act 257. Chevron's expert testified that "in all likelihood" the combined consequences of Act 257 would be an economic loss for the dealer/lessees and an increase in wholesale gasoline prices:

> Question [by the court]: Then why wouldn't Chevron raise the wholesale price for those stations to completely offset the rent reductions?
>
> Answer [by Dr. Umbeck]: Well, they would certainly try. . . . They would try to raise the wholesale price to recoup as much of the lost rent as they could, and the law of demand operating at each of those individual stations, however, is going to limit the total amount they're able to recoup. In other words, at the stations where they raise the price those stations will have a reduction in the volume of gasoline they sell if the dealer raises his retail prices, which logically he would. . . . At the individual stations that are affected there's going to be less revenue generated in total from gasoline sales because they're going to lose some customers. And so, even if the oil company doesn't recover all of the rent reduction, that does not mean the dealer is going to benefit because the whole revenue stream is smaller. *In fact, in all likelihood both the dealer would lose and the oil company would lose.*

(Emphasis added.)

As the challenger of Act 257, Chevron had an obvious interest in establishing that Act 257 would create a premium for its dealer/lessees since this would suggest that the statute is unconstitutional. Yet Chevron's own expert testified that "in all likelihood" a dealer would lose money. In other words, according to Chevron's own expert, there is

probably no premium created by Act 257. Far from gaining a premium, "in all likelihood" the dealer/lessees will lose money as a result of Act 257.

It is a long way from the quoted passage in *Yee* to the panel's holding in this case. The Court in *Yee* did not say, even in a case where there was an actual premium, that the *Nollan* "substantially advances" test would apply. Nor did the Court say that the "substantially advances" test would apply in a case where there was only the probability of a premium, instead of an actual premium. But even if the Court meant in *Yee* what it did not say, this case is a far cry from *Yee*. Here, the premium is not actual, nor even a mere probability. Rather, "in all likelihood," the premium does not exist.

We took a wrong turn in *Richardson*, we continued on the wrong path in *Chevron I*, and we are now in the wrong place. Under the panel's holding, "virtually all rent control laws in the Ninth Circuit are now subject to the 'substantially advances a legitimate state interest' test[,]" 224 F.3d at 1048 (W. Fletcher, J., concurring in the judgment), and many of those laws may well be held unconstitutional under that test. Rent control is often inefficient and sometimes unfair. *See id.* But we should not confuse inefficiency and unfairness with unconstitutionality.

I respectfully dissent.

CHEVRON USA, INC., a Pennsylvania Corporation, Plaintiff, vs. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; EARL I. ANZAI, Attorney General of the State of Hawaii, Defendants.

CIVIL NO. 97-00933 SOM

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAII

198 F. Supp. 2d 1182; 2002 U.S. Dist. LEXIS 7086

April 1, 2002, Decided
April 1, 2002, Date Opinion Filed

COUNSEL: For Plaintiff: Robert A. Mittelstaedt, Pillsbury Winthrop LLP, San Francisco, CA.

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For Defendants: Charles A. Price, James Koshiba, Koshiba Agena & Kubota, Honolulu, HI.

JUDGES: SUSAN OKI MOLLWAY, UNITED STATES DISTRICT JUDGE.

OPINION BY: SUSAN OKI MOLLWAY

OPINION:

AMENDED FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER

1. INTRODUCTION.

This case is a challenge to a state law that caps the rent an oil company may charge someone who leases a service station owned by the oil company. Plaintiff Chevron U.S.A., Inc. ("Chevron"), argues that Act 257, passed by the Hawaii legislature in 1997, unconstitutionally

effects a regulatory taking because it fails to substantially further a legitimate state interest. The rent cap was instituted as part of the State of Hawaii's response to high gasoline prices. High prices caused the State of Hawaii to file a separate lawsuit, alleging that oil companies had conspired to keep the prices high. While the parties to the antitrust lawsuit reached a settlement, the present rent cap dispute went to trial. The court held a one-day bench trial on February 26, 2002, then ordered evidence reopened and received limited additional testimony on March 25, 2002. Having examined the evidence provided by economists, who were the only witnesses at trial, this court agrees with Chevron that the rent cap in Act 257 is unconstitutional.

This case has had a long history. Filed in 1997, this case was initially assigned to a different district judge, who granted summary judgment for Chevron on the grounds that Act 257 failed to substantially advance a legitimate state interest and therefore effected an unconstitutional taking. *See Chevron U.S.A., Inc. v. Cayetano,* 57 F. Supp. 2d 1003 (D. Haw. 1998). Defendants (collectively "the State") appealed that decision to the Ninth Circuit in *Chevron U.S.A., Inc. v. Cayetano,* 224 F.3d 1030 (9th Cir. 2000) ("Chevron Appeal"). The Ninth Circuit reversed, holding that there were genuine issues of material fact as to whether Act 257 effected an unconstitutional taking by failing to substantially advance its purpose of lowering gasoline prices for consumers. *See id.* at 1038-1041. The Ninth Circuit remanded the case for resolution of questions of fact, including: (1) whether oil companies would offset the benefits of Act 257 by raising the wholesale price of gasoline, and (2) whether incumbent lessee-dealers would sell their leaseholds at a premium representing the

increased value resulting from the rent cap, so that new dealers who had to pay that premium would receive no net benefit from the rent cap to pass on to consumers. *Id.* at 1042.

Based on the evidence presented at the trial held on February 26, 2002, this court[1] finds that Act 257 will not decrease retail gasoline prices. In fact, it will cause retail gasoline prices to increase. Act 257 will also discourage oil companies from investing in lessee-dealer stations. It will create no incentive for lessee-dealers to continue operating their stations through lower operating costs. Instead, Act 257 will create a premium that lessee-dealers can recognize upon selling their leases. Act 257 will not advance the goal of lowering gasoline prices.

II. FINDINGS OF FACT.

Whenever, in the following discussion, this court has mistakenly designated as conclusions of law what are really findings of fact, and vice versa, the court's statements shall have the effect they would have had if properly designated.

This bench trial was conducted in accordance with this court's trial procedures for civil nonjury trials, which are reproduced, in substantially the same form followed here, in Appendix A to this court's decision in *Kuntz v. Sea Eagle Diving Adventures Corp.*, 199 F.R.D. 665 (D. Haw. 2001). The court heard testimony from two expert

[1] Following remand, a new circumstance arose that required the original district judge to recuse himself. The case was reassigned to the present district judge.

witnesses: John Umbeck, Ph.D. ("Prof. Umbeck"), who testified on behalf of Chevron, and Keith Leffler, Ph.D. ("Prof. Leffler"), who testified on behalf of the State. Direct examinations of both witnesses were submitted to this court in the form of written declarations. Both witnesses appeared live for cross-examination and redirect examination. The court admitted into evidence three exhibits: Defendant's Ex. 1 (Prof. Leffler's direct testimony by declaration), Plaintiff's Ex. 14 (Prof. Umbeck's direct testimony by declaration), and Plaintiff's Ex. 15 (pages A2-A5 of Exhibit A attached to the Stipulation Re: Adoption of Stipulation of Facts for Trial, filed Feb. 22, 2002).

For ease of reference by the parties and the court, the following findings are presented in numbered paragraphs.

Background.

1. On June 21, 1997, the State of Hawaii enacted Act 257. Stip. of Facts ¶ 1. Act 257 regulates the maximum rent an oil company may charge a dealer that leases a service station from the oil company. The rent is capped at 15 percent of the dealer's gross margin on actual gasoline sales. Haw. Rev. Stat. § 486H-10.4(c)(2) (1998). Act 257 does not apply to any dealer lease in effect on August 1, 1997. Stip. of Facts ¶ 40.

2. In passing Act 257, the legislature was concerned about the level of concentration at the wholesale level in the gasoline industry. Trial Testimony by Keith Leffler, Tr. at 89:7-14, 96:18-24. The legislature passed Act 257 to reduce gasoline prices for Hawaii's consumers. *See Chevron Appeal*, 224 F.3d at 1033 n.3.

3. Hawaii's gasoline market is an oligopoly at the wholesale level but very competitive at the retail level. An oligopoly is a market with few sellers. Decl. of Keith Leffler (Ex. 1) ¶ 9. A competitive market, by contrast, is one with many sellers. Decl. of Keith Leffler (Ex. 1) ¶ 9.

4. In a competitive market, no one seller is individually significant enough to have a measurable impact on the industry supply. Sellers therefore act independently of each other. A market with only a few sellers is a "highly concentrated" market. In such a market, each seller recognizes that its decisions will significantly affect the market and its competitors. Each seller therefore takes into account how its competitors will react to its decisions about marketing, supply, and price. The sellers are interdependent, rather than independent, competitors. Reduced competition is likely when the market is highly concentrated. In an oligopoly, an individual firm pursuing its own individual interests will not "rock the boat" and will try to avoid price wars and battles for market share. High concentration may have the anticompetitive effect of causing what few firms there are to cooperate tacitly, resulting in high prices to consumers. Decl. of Keith Leffler (Ex. 1) ¶ 10.

5. The level of concentration in an industry may be measured by the Herfindahl Hirschman Index, or HHI. The HHI is calculated by adding the squared values of the market shares of each company in the industry. Trial Testimony by Keith Leffler, Tr. at 90:22-91:1. If the HHI in a market exceeds 1,800, that market is considered highly concentrated. Trial Testimony by Keith Leffler, Tr. at 91:6-9. The HHI is used by the Department of Justice and the Federal Trade Commission, among others, to measure

concentration levels. Trial Testimony by Keith Leffler, Tr. at 89:18-21.

6. In 1997, Hawaii had two refineries that supplied gasoline to essentially six wholesalers. Decl. of Keith Leffler (Ex. 1) ¶ 9. With an HHI greater than 1,800, the wholesale gasoline market in Hawaii is highly concentrated. Trial Testimony by Keith Leffler, Tr. at 91:10-12.

7. Hawaii's retail gasoline stations come in three types: company-operated stations, which are owned and operated by oil companies marketing their own products; lessee-dealer stations, which are leased by retail dealers from oil companies; and independent stations, sometimes called "two-party dealers" or "open dealers," which are stations that are neither owned by nor leased from oil companies and that make their own decisions about whose gasoline they will buy. Decl. of John Umbeck (Ex. 14) ¶ 6. Company-operated stations tend to enjoy more efficiencies than lessee-dealer stations. On average, when the gasoline price charged to the dealers (the "Dealer Tank Wagon price" or "DTW") is held constant, company-operated stations charge less for gasoline than other stations. Trial Testimony by Keith Leffler, Tr. at 111:5-16.

8. With an HHI of around 150, the retail gasoline market in Hawaii is very unconcentrated, or highly competitive. Trial Testimony by Keith Leffler, Tr. at 96:7-17. To calculate the HHI at the retail level, Prof. Leffler, testifying for the State, grouped together all stations operated by a single oil company, counting them as a single entity deciding on retail prices as a unit. Stations operated by lessee-dealers and open dealers were counted individually, on the theory that such stations decided on

retail prices independently. Trial Testimony by Keith Leffler, Tr. at 95:6-9.

9. Under Chevron's lessee-dealer arrangement, Chevron purchases land or leases it from a third party, makes the entire investment to build the service station and to build the related facilities on each location, and leases the land and facilities to the dealer on a turn-key basis. Stip. of Facts ¶ 7. Chevron incurs ongoing expenses attributable to the lessee-dealer rental property, such as ground lease rents, real property taxes, ordinary maintenance (subject to the terms and conditions of the dealer lease), and the accounting expense entry of "depreciation." Stip. of Facts ¶ 8.

10. Chevron's lessee-dealer arrangements have two parts. There is a lease under which Chevron charges the lessee-dealer a monthly lease rent. There is a separate supply contract under which Chevron sells motor fuels to the lessee-dealer at a price unilaterally determined by Chevron. Chevron does not enter into a dealer lease unless the dealer simultaneously executes a supply contract with Chevron. Stip. of Facts ¶ 9. In other words, Chevron requires each lessee-dealer to market Chevron-branded gasoline purchased directly from Chevron as a condition of Chevron's entering into a lease with the dealer. Stip. of Facts ¶ 15. Although any dealer that installs its own pumps and tanks is legally free to purchase non-Chevron gasoline, each Chevron lessee-dealer in Hawaii currently obtains (and has obtained for at least the last 10 years) its supply of gasoline exclusively from Chevron. Stip. of Facts ¶ 16.

11. Effective January 1, 1997, Chevron implemented a new nationwide dealer rental program that restructured

the manner in which Chevron calculated rents paid under service station leases. Stip. of Facts ¶ 2. Chevron's dealer leases run for three-year terms. The exception is that, if Chevron is leasing land for a particular service station from another party under a ground lease that expires in less than three years, the dealer lease expires when the ground lease expires. Stip. of Facts ¶ 24.

12. The lease rent cap provisions contained in Act 257 prohibit complete implementation in Hawaii of the rent rates specified in Chevron's new dealer rental program. Stip. of Facts ¶ 3. Absent Act 257, Chevron would have charged "motor fuel facilities rent" that would have been a percentage of the dealer's gross margin on motor fuel sales (total motor fuel sales volume multiplied by weighted average per gallon margin). Chevron's new rental program had three different percentage brackets applied on an incremental basis to the monthly gross margin on fuel. The rent would have been 18 percent on the portion up to $18,000; 32 percent on the portion between $18,000 and $28,000; and 38 percent on the portion over $28,000. However, Act 257 does not allow Chevron to charge the "motor fuel facilities" rent that it otherwise would have charged. Stip. of Facts ¶ 4. The rental provisions of Act 257 also cause Chevron to require that dealers account for automotive service bay sales, which it otherwise would not do. Stip. of Facts ¶ 6. Act 257 has no direct impact on non-motor fuel facilities rent under Chevron's rental program because the 15 percent cap is greater than what Chevron would have otherwise charged as non-motor fuel facilities rent without Act 257. Stip. of Facts ¶ 4.

13. Chevron estimates that, after all lessee-dealer agreements in Hawaii are renewed under Act 257, the Act

will preclude Chevron from charging the rent it otherwise would have charged for 11 of Chevron's 64 lessee-dealer stations in Hawaii. Stip. of Facts ¶ 5; *see also* Table 1, attached to Stip. of Facts.[2]

14. Chevron has invested more than $58,000,000 in its current lessee-dealer service stations and related facilities in Hawaii. The present book value of those same service stations and related facilities is more than $37,000,000. Stip. of Facts ¶ 10. The maximum amount of rent Chevron projects it could receive under the statutory scheme imposed by Act 257, when applied to all Chevron dealer leases in Hawaii, is $6,126,646 for the 12-month period from January 1, 1998, through December 31, 1998. Stip. of Facts ¶ 12. Chevron's projected expenses during the 12-month period from January 1, 1998, to December 31, 1998, for its lessee-dealer stations in Hawaii, i.e., ground lease rents, real property taxes, ordinary maintenance, depreciation, and other direct station expenses, total $6,292,855, exceeding Chevron's projected rental income by $166,209. Stip. of Facts ¶ 13.

15. Chevron would not invest in lessee-dealer stations except for its expectation that Chevron gasoline will be sold at such stations. Stip. of Facts ¶ 14. Chevron recovers its expenses and investment costs relating to

[2] Table 1 is an accurate summary of the projected rents for each Chevron lessee-dealer station in Hawaii for the first year of Act 257. Table 1 also reflects the agreement Chevron has with its lessee-dealers pending final disposition of this lawsuit. That agreement limits the rent Chevron charges during the pendency of this lawsuit but provides for dealers who benefit from that limit to make additional payments to Chevron in the event Chevron prevails in this lawsuit. Stip. of Facts ¶¶ 5, 11. The court has no empirical data on the full impact of Act 257.

lessee-dealer stations (ground-lease rents, real property taxes, ordinary maintenance, and depreciation) in Hawaii and throughout the United States through the combination of rental revenue and earnings on Chevron gasoline sold through the stations. Stip. of Facts ¶ 17.

16. Chevron's evaluation of the return on investment from the development of new lessee-dealer stations in Hawaii and throughout the United States includes in the return a measure of the expected earnings from the sale of Chevron-branded gasoline at the station. Stip. of Facts ¶ 18.

17. In the aggregate, Chevron has not within the last 20 years recovered its expenses relating to dealer stations (ground lease rents, real property taxes, ordinary maintenance, and depreciation) in Hawaii or elsewhere in the United States from dealer station rents. Stip. of Facts ¶ 23.

18. However, when all sources of revenue are considered, Chevron has positive net earnings from selling gasoline to Hawaii resellers. Stip. of Facts ¶ 22.

Oil companies will raise wholesale gasoline prices to offset any decrease in rent imposed by Act 257, and this increase in wholesale prices will cause retail prices to increase.

19. It makes no sense to consider revenues from rent separately from revenues from gasoline sales for purposes of an economic analysis. Oil companies consider both sources of revenues in setting their rents and gasoline prices and in making investment decisions. Trial Testimony by John Umbeck, Tr. 61:9-62:9, 104:21-105:13. Chevron determines the optimal mix between rent and

gasoline charges based on the total package cost that dealers or the market will permit. Different oil companies have different views on the optimal mix. Trial Testimony by Keith Leffler, Tr. at 97:14-20, 145-6:146-21.

20. A fixed cost, or sunk cost, is one that occurs "independently of how much the firm produces, or whether it produces at all." Decl. of Keith Leffler (Ex. 1) ¶ 22 (quoting G. Silberberg, Principles of Microeconomics 261 (Prentice Hall 1995)). Rent is a fixed cost. Trial Testimony by John Umbeck, Supp. Tr. at 10:8-13.

21. Both sides agreed that, because rent is a fixed cost, lessee-dealers will not pass the savings from a decrease in rent onto consumers in the form of lower retail prices. Instead, dealers will pocket the savings. Therefore, a decrease in rent will not, by itself, lower the retail price. Trial Testimony by John Umbeck, Supp. Tr. at 9:15-10:13, 11:17-12:8.

22. To the extent observations on the subject are available, demand for gasoline is inelastic in Hawaii. Elasticity is determined by comparing the percentage change in the quantity of gasoline sold to the percentage change in the price of gasoline. Trial Testimony by John Umbeck, Tr. at 34:9-14. Thus, to say the demand appears inelastic is to say that, to the extent observations have been made on the subject, changes in the retail price of gasoline have caused the volume of gasoline purchased to change by proportionally less than the change in price.

23. Chevron will increase its wholesale gasoline price to offset the reduction in rental revenue it receives as a result of Act 257. Decl. of John Umbeck (Ex. 14) ¶ 20. Dealers will respond to the increase in the wholesale price by raising retail prices. Trial Testimony by Keith Leffler,

Tr. at 100:4-9, 142:3-8, 142:21-23; Trial Testimony by John Umbeck, Supp. Tr. at 6:3-5, 10:13-16, 12:9-10. This will cause the volume of gasoline sold by Chevron to decrease because the customers at Chevron stations that increase retail prices will respond to the higher retail prices by purchasing less gasoline and by defecting to stations that have not raised retail prices. Trial Testimony by John Umbeck, Supp. Tr. at 6:5-8.

24. This decrease in volume will prevent Chevron from raising the wholesale price enough to offset completely lost rental revenues. Chevron will be able to offset those lost revenues only partially. Trial Testimony by John Umbeck, Supp. Tr. at 5:15-6:10.

25. Chevron may accomplish this partial offset by raising wholesale prices only for the lessee-dealer stations affected by Act 257's rent cap. Setting wholesale prices for specific stations would be a change in Chevron's pricing practice in Hawaii. In Hawaii, Chevron's current policy is to treat each island as a separate wholesale price zone. Presumably, this policy is optimal for maximizing profits. In some markets, such as Los Angeles and San Francisco, where administrative costs are not prohibitive, Chevron has multiple price zones within a city. To do the same in Hawaii would not cause administrative costs to increase very much. Trial Testimony by John Umbeck, Supp. Tr. at 6:19-8:12.

26. Testifying for the State, Prof. Leffler opined that Chevron will not raise the wholesale price in response to the rent cap. The court is not persuaded by Prof. Leffler. Prof. Leffler opined that Chevron would not raise the wholesale gasoline price because that would cause retailers to buy less gasoline from Chevron. Decl. of Keith

Leffler (Ex. 1) ¶ 16. Prof. Leffler explained that, as any rational oil company would maximize its profit, the wholesale price charged even without the effect of Act 257 must already be the highest price the oil company could charge to maximize its profits. He concluded that Act 257 would therefore not cause an increase in the wholesale price because this would not maximize profits. Decl. of Keith Leffler (Ex. 1) ¶ 17; Trial Testimony by Keith Leffler, Tr. at 185:22-186:14, Supp. Tr. at 13:22-14:5. According to Prof. Leffler, the wholesale price turns on demand, supply, and the relationships among the few suppliers, not on rent. Decl. of Keith Leffler (Ex. 1) ¶ 17.

27. Prof. Leffler ignores the relationship of rent to the wholesale price. As noted above, oil companies look at their total return and find the optimal mix among sources of revenue. The wholesale price is always set in light of the rent being charged. Trial Testimony by John Umbeck, Supp. Tr. at 15:5-23. Typically, dealer rents are below market, so the idea of "profit maximizing" does not appear to apply to individual components of the total return. Trial Testimony by John Umbeck, Tr. at 68:14-69:11.

28. Testifying for Chevron, Prof. Umbeck opined that Chevron would raise the wholesale gasoline price despite the possibility that sales would decrease if retail prices increased as a result. Prof. Umbeck noted that, even with a loss in sales volume, an increase in its wholesale price would allow Chevron to recoup part of the rent reduction, while holding wholesale prices steady would force Chevron to bear the full impact of the rent reduction. Decl. of John Umbeck (Ex. 14) ¶ 22.

29. Implicit in Prof. Umbeck's opinion is the assumption that Chevron will risk a drop in sales volume in the

hope that it will be outweighed by the increase in the wholesale price, such that wholesale gasoline revenues increase. If Chevron holds wholesale prices steady, then Chevron is guaranteed to lose the full difference between the rent it would have charged and the maximum rent allowed by Act 257. Under these circumstances, there is no evidence that Chevron would choose the guaranteed drop in revenue that would result from the rent cap if wholesale prices were not changed, rather than at least some possible recoupment of the reduced rent revenue through increased wholesale prices.

30. Prof. Umbeck's testimony is more persuasive than Prof. Leffler's on this point. At trial, the court had the opportunity to observe the demeanor of both witnesses during their cross-examinations and redirect examinations. Both were qualified as experts by the court, without objection by any party, and were permitted to present opinions in this case under Fed. R. Evid. 702. Both were clearly experienced economists well-versed in the circumstances of this case. Neither witness gave the court any reason to think the witness was insincere, although both were cautious and guarded in their responses. On occasion, both appeared reluctant to answer particular questions directly, attempting instead to impose boundaries to the questions, sometimes more than appeared warranted. Prof. Umbeck engaged in this practice more than Prof. Leffler did. Nevertheless, on the issue of whether wholesale prices would increase, the court was ultimately persuaded by Prof. Umbeck that they would increase. The court looked for but cannot point to demeanor evidence supporting this finding. The court instead relies on the logic and consistency of Prof. Umbeck's testimony on this point, as noted in the preceding paragraphs.

31. Act 257 will not advance its stated interest of lowering consumer gasoline prices. As noted above, lessee-dealers will not pass on any savings in rent to consumers in the form of lower retail prices. Instead, dealers will pocket the savings for themselves. The direct effect of Act 257 will actually be to cause retail gasoline prices to increase in response to higher wholesale gasoline prices, as noted above.

Act 257 will enable lessee-dealers to sell their leaseholds at a premium.

32. Chevron's leases and supply contracts with lessee-dealers permit the lessees to assign their occupancy rights, subject to obtaining Chevron's written consent and paying a transfer fee set by Chevron before the assignment of any lease or any interest in a lease. Stip. of Facts ¶ 26.

33. Neither Chevron's dealer lease nor Chevron's dealer supply contract limits the price at which a lessee-dealer may sell, convey, or otherwise transfer its occupancy rights. Stip. of Facts ¶ 27. Nor does Act 257 prohibit the sale, conveyance, or other transfer of leases by service station dealers, or limit in any way the price at which a lessee dealer may sell, convey, or otherwise transfer its interest in a service station lease. Stip. of Facts ¶¶ 28, 29.

34. From 1992 to 1998, 14 Chevron lessee-dealers sold their interests in their gasoline stations to other entities. Stip. of Facts ¶ 32. Chevron expects that further assignments of leases and supply contracts will occur in the future. Stip. of Facts ¶ 33.

35. In Hawaii, a Chevron lessee-dealer's earnings from gasoline sales depend on factors that include the

dealer's expertise and business acumen, the location of the station, the features of the station, the location of competitors' stations, the pricing at competitors' stations, the lessee-dealer's rent, other station costs, and the price paid by the dealer to Chevron for gasoline. Stip. of Facts ¶ 26.

36. Assuming everything else remains equal, the market value of a lessee-dealer's leasehold could reasonably be expected to increase as the amount of the rent payable decreases. Stip. of Facts ¶ 35.

37. Having accepted Chevron's argument that wholesale prices will increase in response to the rent cap, the court finds that "everything else," referred to in the preceding paragraph, will not remain equal. Nevertheless, a preponderance of the evidence establishes that Act 257 will enable lessee-dealers to sell their leaseholds at a premium.

38. Act 257's rent cap will generate a premium that reflects the difference between the incumbent dealer's expected market rent and the lower rent resulting from Act 257, discounted by the appropriate interest rate for the expected life of the station. Decl. of John Umbeck (Ex. 14) ¶ 23. As noted above, the increase in wholesale gasoline prices will not completely offset the decrease in rent. The resulting benefit to the lessee-dealer shows up in the premium.

39. Prof. Leffler disagreed that Act 257 would create a premium. He pointed to the many unknown variables that would affect the creation of a premium, such as future rent, future gasoline margins, and stations' sales of products other than gasoline. Decl. of Keith Leffler (Ex. 1) ¶ 24. The court disagrees. Economic theory takes these unknown variables into account by predicting expected

values that will be capitalized in the form of a premium. Decl. of John Umbeck (Ex. 14) ¶ 29. Even though some purchasers may overestimate or underestimate the value of the premium, on average, the value of each premium paid will equal the actual present value of the rent reduction. Decl. of John Umbeck (Ex. 14) ¶ 30.

40. Prof. Leffler opined that a second reason lessee-dealers would not fully capture a premium from rent reductions is that the market for the sale of lessee-dealer rights in Hawaii is not perfectly competitive. Decl. of Keith Leffler (Ex. 1) ¶ 24. Again, the court disagrees. Prof. Leffler admitted on cross-examination that he did not know whether the market is perfectly competitive or not. Testimony by Keith Leffler, Tr. at 98:13-24. Moreover, the evidence Prof. Leffler relied on did not actually prove his point. Prof. Leffler relied on the low number of sales of dealer rights per year. Decl. of Keith Leffler (Ex. 1) ¶ 24. However, the number of sales of dealer rights per year says nothing about the competitive nature of the market. For example, perfect competition may take the form of an auction with many potential buyers who bid against each other. Even though only one sale is actually made, the market is still perfectly competitive. Because a lessee-dealer will not sell his lease unless he receives an offer price with a present value equal to the present value of his expected income stream, the sale price will fully capture the original dealer's expected future value in the form of a premium. Decl. of John Umbeck (Ex. 14) ¶ 31.

41. At trial, the court expressed concern that the State had not cross-examined Prof. Umbeck at all on the issue of the asserted premium. The court had envisioned that, in the wake of the Ninth Circuit's decision in this case, both parties would conduct vigorous cross-examination on

all issues. That did not occur. The State's counsel explained that the State had made a "strategic decision" not to touch the premium issue. Tr. at 200:13-203:11. The court would have been greatly aided by crossexamination on this subject. The Ninth Circuit clearly contemplated that such cross-examination would illuminate the factfinding process. Without the anticipated cross-examination, the court examines whether Chevron's argument as to the existence of a premium is supported by a preponderance of the evidence. It is.

Instead of decreasing retail gasoline prices by maintaining the presence of lessee-dealers in the market, Act 257 will increase retail gasoline prices by reducing the number of lessee-dealers.

42. Prof. Leffler testified that gasoline prices in Hawaii are relatively high at the wholesale and retail levels because of (a) high taxes; (b) high concentration at the wholesale level; and (c) high barriers to entry that dissuade new companies from entering the market. These barriers include substantial fixed costs, regulatory impediments to building new terminals, an oversupply of gasoline stations in the market, and an adverse political climate, including rent controls, government proposals to take over petroleum terminals, and restrictions on the location and types of stations that may be built. Trial Testimony by Keith Leffler, Tr. at 114:13-117:14, 118:17-120:8.

43. The State contends that Act 257 will prevent oil companies from raising lessee-dealers' rents to unprofitable levels and thereby driving them out of business. *See* Defs.' Final Written Argument at 1-2. The State argues that, by maintaining the presence of lessee-dealers, Act

257 will lessen the anti-competitive impact of the highly concentrated wholesale gasoline market. Act 257 will do this, according to the State, by (a) preventing increased concentration at the retail level and (b) deterring cooperative pricing among the relatively few suppliers of gasoline at the wholesale level. Decl. of Keith Leffler (Ex. 1) ¶¶ 13, 14. The court is unpersuaded.

44. Prof. Leffler admitted that the rents that Chevron and other oil companies charge their lessee-dealers do not cause wholesale and retail gasoline prices in Hawaii to be high. Trial Testimony by Keith Leffler, Tr. at 120:11-16, 121:17-24.

45. Admittedly, the rent cap of Act 257 precludes oil companies from raising rents to levels designed to drive lessee-dealers out of business. Decl. of Keith Leffler (Ex. 1) ¶¶ 19. However, there is no evidence that, but for Act 257, Chevron or any other oil company would try to drive its lessee-dealers out of business in Hawaii by charging excessive rent. In fact, at the time Act 257 went into effect in 1997, Chevron charged rents that were relatively low. Trial Testimony by Keith Leffler, Tr. at 105:19-25, 162:11-163-5.

46. Prof. Leffler admitted that the percentage of lessee-dealers does not affect the wholesale concentration level or any of the other causes of high wholesale and retail gasoline prices in Hawaii. Trial Testimony by Keith Leffler, Tr. at 120:23-121:7, 121:12-16.

47. Act 257 will not alter the concentration level in the wholesale gasoline market. If Act 257 were to have any impact, it would be at the retail level, i.e., on the number of retail gasoline stations and lessee-dealers. Trial Testimony by John Umbeck, Tr. at 66:9-17.

48. Oil companies, not lessee-dealers, decide whether to build new lessee-dealer stations. Trial Testimony by Keith Leffler, Tr. at 123:1-9. Therefore, to determine how Act 257 affects decisions to build new lessee-dealer stations, the court focuses on the oil company's economics. Those economics will cause the number of lessee-dealer stations to decrease.

49. By reducing rental revenues, Act 257 discourages oil companies from investing in lessee-dealer stations rather than other types of gas stations. As noted above, the decrease in rental revenue will not be completely offset by an increase in the wholesale gasoline price. Therefore, oil companies will receive less total revenue from lessee-dealer stations than before, leading oil companies to avoid investing in new and existing lessee-dealer stations. This means that there will ultimately be fewer lessee-dealer stations than there would be without Act 257. Decl. of John Umbeck ¶¶ 15-17; Trail Testimony by Keith Leffler, Tr. at 182:12-19.

50. Act 257's rent cap will not cause lessee-dealers to remain in the market longer by lowering their operating costs. Although lessee-dealers will not have to pay as much rent, they will have the opportunity to capture the value of the rent reduction upon sale in the form of a premium, which they can then invest and earn a return on. Lessee-dealers will incorporate the cost of this opportunity into their operating costs. This opportunity cost will be exactly equal to the reduction in the monthly rent. Therefore, lessee-dealers' total operating costs will not decrease, and they will have no incentive to remain in the market longer than they otherwise would have. Decl. of John Umbeck ¶ 25.

51. Fewer lessee-dealer stations in the market means that retail prices will increase. In the first place, fewer lessee-dealers means greater concentration at the retail level, which means less intrabrand and interbrand competition. In the second place, the fewer lessee-dealers there are, the easier it is for wholesale gasoline suppliers to engage in cooperative pricing, leading ultimately to higher wholesale and retail prices. Decl. of Keith Leffler ¶¶ 13-15.

III. CONCLUSIONS OF LAW.

1. The Takings Clause of the Fifth Amendment of the United States Constitution states, in relevant part, "Nor shall private property be taken for public use, without just compensation." U.S. Const. amend. V. The Takings Clause applies to the states through the Fourteenth Amendment. *See, e.g., Dolan v. City of Tigard,* 512 U.S. 374, 383-84, 129 L. Ed. 2d 304, 114 S.Ct. 2309 (1984).

2. "[W]hile property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Chevron Appeal,* 224 F.3d at 1033 (quoting *Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393, 415, 67 L. Ed. 322, 43 S. Ct. 158 (1922)).

3. Act 257 effects a regulatory taking if it does not "substantially advance a legitimate state interest." *See Chevron Appeal,* 224 F.3d at 1037; *see generally Agins v. City of Tiburon,* 447 U.S. 255, 260, 65 L. Ed. 2d 106, 100 S. Ct. 2138 (1980). Chevron has the burden of proving by a preponderance of the evidence that Act 257 does not substantially advance a legitimate state interest. *Chevron Appeal,* 224 F.3d at 1037.

4. The State has a legitimate state interest in lowering consumer gasoline prices. *See Chevron Appeal,* 224 F.3d at 1033 n. 3; *see also Nollan v. California Coastal Com'n,* 483 U.S. 825, 834-35, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987) (a broad range of governmental purposes satisfies the requirement of a legitimate state interest).

5. Act 257 does not substantially advance this legitimate state interest. To the contrary, as noted above, Act 257 will cause consumer gasoline prices to increase. Gasoline suppliers will raise wholesale gasoline prices to offset the reduction in rental income, causing dealers to raise retail gasoline prices in response. Act 257 will also cause retail prices to increase by reducing the presence of lessee-dealers in the market. Act 257's rent cap discourages oil companies from investing in lessee-dealer stations. Under the Petroleum Marketing Practices Act (the "PMPA"), 15 U.S.C. §§ 2801-2806 (1998), an oil company may decline to renew a franchise relationship if renewal is "likely to be uneconomical to the franchisor," 15 U.S.C. § 2802(b)(3)(D)(i)(IV) (1998), subject to certain conditions, *see* 15 U.S.C. § 2802(b)(3)(D)(ii)-(iii) (1998).

6. Under Act 257, a lessee-dealer realizes a premium if it sells its leasehold. While premiums are not all unconstitutional *per se,* Act 257's premium undermines the legitimate state interest in lowering consumer gasoline prices. In *Richardson v. City and County of Honolulu,* 124 F.3d 1150, 1165-66 (9th Cir. 1997), the Ninth Circuit held a rent cap unconstitutional because the rent cap did not substantially further a legitimate state interest. *Richardson* concerned the constitutionality of the City and County of Honolulu's Ordinance 91-96. Ordinance 91-96 capped renegotiated rents on the land underlying owner-occupied

condominiums and provided that, if a lease was transferred to another owner-occupant, the transferee would enjoy the benefit of the capped rent. *See id.* at 1163-64. Ordinance 91-96 therefore was intended to create affordable owner-occupied housing directly by decreasing the land rents that condominium owner-occupants had to pay. *See id.* at 1165. However, the Ninth Circuit found that the price of housing would not ultimately change because an owner-occupant who sold his condominium would charge the buyer a premium reflecting the value of the decreased land rent. The lack of a mechanism to preclude lessees from capturing this premium prevented Ordinance 91-96 from substantially furthering a legitimate state interest, thereby rendering it unconstitutional. *See id.* at 1166.

7. Unlike Ordinance 91-96, Act 257 was not designed to lower retail gasoline prices directly through reduced rents. The parties agree that any rent savings will be pocketed by lessee-dealers. Instead, the State says, Act 257 will lower retail gasoline prices indirectly, by maintaining the presence of lessee-dealers in the market through reduced operating costs. Act 257 fails to accomplish this goal because lessee-dealers who benefit from Act 257's rent cap will be able to sell their leaseholds at a premium. The opportunity to capture this premium will be reflected as an operating cost, which will be equal in magnitude to the reduction in rent the lessee-dealers enjoy. Therefore, lessee-dealers' total operating costs will not change, giving lessee-dealers no added incentive to remain in the market.

8. There is no evidence that Act 257 will protect any lessee-dealer from being driven out of the market. There is no evidence that, but for Act 257, oil companies would try to drive lessee-dealers out of business by raising rents.

Moreover, the PMPA already prevents an oil company from raising rents for the purpose of driving dealers out of business and converting the premises to company-operated stations. 15 U.S.C. § 2802(b)(3)(A)(ii) (1998).

9. Act 257 effects an unconstitutional regulatory taking given its failure to substantially advance any legitimate state interest.

IV. ORDER.

Based on the above findings of fact and conclusions of law, the court declares the rent cap in Act 257 unconstitutional. Act 257's imposition of a cap on the rent that an oil company may charge a lessee-dealer does not substantially advance the State's legitimate interest in lowering gasoline prices. The previously entered judgment in favor of Chevron stands.

IT IS SO ORDERED.

DATED: Honolulu, Hawaii, April 1, 2002.

SUSAN OKI MOLLWAY
UNITED STATES DISTRICT JUDGE

CHEVRON USA, INC., a Pennsylvania Corporation, Plaintiff-Appellee, v. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; EARL I ANZAI,* Attorney General of the State of Hawaii, Defendants-Appellants.

***Earl I. Anzai is substituted for his predecessor Margery S. Bronster, as Attorney General for the State of Hawaii. Fed. R. App. P. 43(c)(2).**

No. 99-15108

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

224 F.3d 1030; 2000 U.S. App. LEXIS 22938; 2000 Cal. Daily Op. Service 7631; 2000 Daily Journal DAR 10129; 31 ELR 20091

November 4, 1999, Argued and Submitted, Honolulu, Hawaii
September 13, 2000, Filed

COUNSEL: Jack A. Rosenzweig and Ted Gamble Clause, Deputy Attorneys General, Honolulu, Hawaii, for the defendants-appellants.

Robert C. Phelps and Craig E. Stewart, Pillsbury, Madison & Sutro, San Francisco, California, for the plaintiff-appellee.

JUDGES: Before: Dorothy W. Nelson, Robert R. Beezer, and William A. Fletcher, Circuit Judges. Opinion by Judge Beezer; Concurrence by Judge W. Fletcher.

OPINION BY: Robert R. Beezer

OPINION:

BEEZER, Circuit Judge:

Hawaii Governor Benjamin J. Cayetano and Attorney General Earl I. Anzai (collectively "the State") appeal the district court's judgment in favor of Chevron U.S.A., Inc. Chevron filed suit for declaratory and injunctive relief against enforcement of Section 3(c) of Act 257 of the 1997 Hawaii State Legislature ("Act 257"). Act 257, inter alia, proscribes the maximum rent that oil companies can collect from dealers who lease company-owned service stations. Both parties moved for summary judgment on whether the maximum permissible regulated rent effects an unconstitutional regulatory taking. After concluding that it does, the district court granted Chevron's motion and denied the State's motion. The State appeals only the grant of summary judgment to Chevron; it does not appeal the denial of its own motion. We have jurisdiction under 28 U.S.C. § 1291. Because genuine issues of material fact exist, we vacate the judgment and remand for further proceedings.

I

In response to concerns about the highly concentrated gasoline market in Hawaii and the resulting high cost of gasoline to consumers, the Hawaii Legislature enacted Act 257 on June 21, 1997.[1] Act 257, inter alia, regulates the maximum rent an oil company can charge dealers who lease its service stations.

Chevron is one of two gasoline refiners and one of six wholesalers in Hawaii. At the retail level, Chevron sells

[1] The relevant portions of Act 257 were later codified as Hawaii Revised Statute § 486H-10.4.

most of its gasoline through company-owned stations, which are leased to independent dealers. Chevron leases 64 service stations to dealers in Hawaii. From 1984 through the end of 1996, Chevron relied on *estimated* gasoline sales to calculate the rent owed by the lessee dealers. After determining that the amount of gross rent receipts was not satisfactory, Chevron initiated a new nationwide dealer rental program in January 1997. Chevron restructured the manner in which it calculated lease rates. This program, which the parties agree would be in effect in Hawaii absent Act 257, requires the lessee dealer to pay a monthly rent, consisting of an escalating percentage of the dealer's gross margin on actual, rather than estimated, gasoline sales. For instance, the rent would be calculated as 18% of the gross margin up to $18,000; 32% of the portion between $18,000 and $28,000; and 38% of the portion over $28,000. In contrast, Act 257 establishes a maximum regulated rent of 15% of gross margin.

The maximum rents Chevron projects it could receive under the statutory scheme imposed by Act 257 totals $6,126,646 for 1998. Chevron's projected expenses total $6,292,855, exceeding Chevron's projected rental income by $166,209. Chevron concedes, however, that it has not fully recovered its expenses relating to dealer stations (including ground lease rents, real property taxes, ordinary maintenance and depreciation) from rent in any state in the last 20 years.

Instead, Chevron relies on supply contracts to earn a profit. Dealers who choose to rent a station from Chevron must, as a condition of their lease, agree to purchase from Chevron all of the fuel necessary to satisfy demand at that station for Chevron gasoline. The price under the supply

contract is unilaterally set by Chevron. Both the lease agreement and the supply contract permit the dealer to transfer his or her occupancy rights upon obtaining Chevron's written consent and paying a transfer fee set by Chevron. Act 257 does not prohibit such transfers.

In conjunction with the alienability of the leaseholds, the parties stipulated to the following facts:

> 34. The existing dealer at the time of the enactment of Act 257 may be able to sell his leasehold at a premium that derives from the value of the dealer's leasehold interest, given the reduced rent imposed by Act 257, assuming Chevron does not object in good faith when the selling dealer seeks Chevron's consent to the assignment.
>
> 35. Assuming everything else remains equal, the market value of the lessee-dealer leasehold reasonably could be expected to increase as the amount of the rent payable decreases.

Based largely on these facts, Chevron moved for summary judgment on its takings claim.[2] Chevron argued that Act 257 effects a regulatory taking because it fails to substantially advance a legitimate state interest. Chevron also maintained that Act 257 prevents the company from receiving a just and reasonable return. Finally, Chevron contended that Act 257 is unconstitutional because it neither provides individualized consideration, nor contains a mechanism for obtaining relief from confiscatory rent

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[2] Chevron's other three claims (42 U.S.C. § 1983, due process and equal protection) were dismissed without prejudice by stipulation of the parties and are not at issue in this appeal.

cap provisions. Because the district court resolved the first argument in Chevron's favor, it declined to reach the other two.

On appeal, the State challenges both the standard used by the district court to evaluate Chevron's regulatory taking claim and the court's application of that standard in the summary judgment context.

II

"States have broad power to regulate . . . the landlord-tenant relationship . . . without paying compensation for all economic injuries that such regulation entails." *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 440, 73 L. Ed. 2d 868, 102 S. Ct. 3164 (1982). When a landowner decides to rent his land to tenants, the government may place ceilings on the rents the landowner can charge. *See, e.g., Pennell v. San Jose,* 485 U.S. 1, 11-12, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988). "While property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393, 415, 67 L. Ed. 322, 43 S. Ct. 158 (1922).

The question in this case is whether Act 257 goes too far. To analyze that question, the district court concluded that "the appropriate inquiry is whether [Act 257] substantially advances a legitimate state interest." In reaching this conclusion, the court explicitly rejected the more deferential standard urged by the State. The State argues that the courts should look only to whether "the

Legislature rationally could have believed the Act would substantially advance a legitimate government purpose."[3]

To support this position, the State relies on a footnote in Chief Justice Rehnquist's dissenting opinion in *Keystone Bituminous Coal Association v. DeBenedictis,* 480 U.S. 470, 94 L. Ed. 2d 472, 107 S. Ct. 1232 (1987):

> Our inquiry into legislative purpose is not intended as a license to judge the effectiveness of legislation. When considering the Fifth Amendment issues presented by Hawaii's Land Reform Act, we noted that the Act, "like any other, may not be successful in achieving its intended goals. But 'whether in fact the provisions will accomplish the objectives is not the question: the [constitutional requirement] is satisfied if . . . the . . . [State] Legislature rationally could have believed that the [Act] would promote its objective.'" *Hawaii Housing Authority v. Midkiff,* 467 U.S. 229, 242, 81 L. Ed. 2d 186, 104 S. Ct. 2321 (1984).

Keystone, 480 U.S. at 511 n.3 (alterations in original). The State's reliance on this quote is unsound for two reasons. First, as the district court correctly noted, *Midkiff* dealt with a physical taking, rather than a regulatory one. In a physical taking, the government exercises its eminent domain power to take private property for "public use." Importantly, the government intends to take the property and is willing to pay compensation to the landowner. We

[3] Both the test used by the district court and that suggested by the State require a legitimate state interest. In this case, the district court found that the purpose of Act 257 is to "reduce gasoline prices for Hawaii's consumers." On appeal, the parties do not contest this finding. Likewise, the parties do not dispute the legitimacy of this interest.

have recognized that a more deferential standard applies in those circumstances. *See Richardson v. City and County of Honolulu,* 124 F.3d 1150, 1158 (9th Cir. 1997), *cert. denied,* 525 U.S. 871, 119 S. Ct. 168, 142 L. Ed. 2d 137 (1998) ("We see nothing inconsistent in applying heightened scrutiny when the taking is uncompensated, and a more deferential standard when the taking is fully compensated."); *see also Hall v. City of Santa Barbara,* 833 F.2d 1270, 1280 n.25 (9th Cir. 1986) ("It makes considerable sense to give greater deference to the legislature where it deliberately resorts to its eminent domain power than where it may have stumbled into exercising it through actions that incidentally result in a taking.").

Second, the State's argument is foreclosed by our decision in *Richardson.* In *Richardson,* we established that land use regulations, including rent control ordinances like Act 257 that permit the capture of a premium, do not effect a taking if the regulation "substantially furthers a legitimate state interest." *Richardson,* 124 F.3d at 1164; *see also Keystone,* 480 U.S. at 485 ("Land use regulation can effect a taking if it 'does not substantially advance legitimate state interests, . . . or denies an owner economically viable use of his land.'") (quoting *Agins v. Tiburon,* 447 U.S. 255, 260, 65 L. Ed. 2d 106, 100 S. Ct. 2138 (1980)).

III

While we recognize the concurring opinion's dissatisfaction with our application of the "substantially advances" test, we do not believe that our holding today either expands *Richardson* or contravenes Supreme Court precedent.

Relying on *Pennell v. City of San Jose,* 485 U.S. 1, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988), the concurrence asserts that rent control can ordinarily only be challenged as violative of due process, rather than as a regulatory taking. We read *Pennell* differently. In that case, a landlord challenged the constitutionality of a city rent control ordinance on three grounds: (1) the Takings Clause; (2) Due Process; and (3) Equal Protection. *See id.* at 4. The Court summarized the Takings Clause claim as follows:

> § 5703.28 of the Ordinance establishes the seven factors that a hearing officer is to take into account in determining the reasonable rent increase. The first six of these factors are all objective, and are related either to the landlord's costs of providing an adequate rental unit, or to the condition of the rental market. Application of these six standards results in a rent that is "reasonable" by reference to what appellants contend is the only legitimate purpose of rent control: the elimination of "excessive" rents caused by San Jose's housing shortage. When the hearing officer then takes into account "hardship to a tenant" pursuant to § 5703.28(c)(7) and reduces the rent below the objectively "reasonable" amount established by the first six factors, this additional reduction in the rent increase constitutes a "taking."

Id. at 9.

The Takings Clause claim in *Pennell* was not based on the mere existence of rent control, but was instead dependent on the hardship provision. Indeed, because rent control is not a per se taking, *see FCC v. Florida Power Corp.,* 480 U.S. 245, 252, 94 L. Ed. 2d 282, 107 S. Ct. 1107 (1987), the landlord had to argue why this particular rent

control ordinance effected a taking. To do so, he focused on the hardship provision, as the other factors apparently established a reasonable rent. The Court neither explicitly nor implicitly approved or disapproved of the landlord's argument. In fact, the Court declined to reach the merits of the Takings Clause claim because the hardship provision had never been applied. *See Pennell,* 485 U.S. at 9-10. The Court did proceed to analyze the landlord's remaining constitutional arguments. It did not, however, intimate in any way that rent control provisions should *only* be analyzed under the Due Process Clause. Rather, the Court determined that the Takings Clause claim was premature and then analyzed the Due Process Clause claim under the Due Process "reasonableness" test.

Moreover, to the extent that "something else" is required to challenge a rent control ordinance under the Takings Clause, the existence of the premium in this case suffices. The stipulated possibility that an incumbent dealer will be able to capture the value of the decreased rent in the form of a premium separates Act 257 from an ordinary rent control situation, where such a transfer is prohibited.

Logically, it makes far more sense for us to analyze Chevron's regulatory takings claim under the Takings Clause test than it does to review it under the Due Process Clause test. Chevron raised a Due Process Clause claim in its First Amended Complaint, but chose not to move for summary judgment on that claim. Once the district court in this case granted Chevron's summary judgment motion on the Takings Clause claim, Chevron dismissed its remaining claims without prejudice. Thus, there is no Due Process claim for us to review, even if we were so inclined.

The concurring opinion also downplays the significance of the Supreme Court's language in *Yee v. City of Escondido,* 503 U.S. 519, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992). Although the Court in *Yee* did not conclusively announce the applicable test for a regulatory takings challenge to a rent control statute, it did suggest that the possibility of a premium similar to the one in this case "might have some bearing on whether the ordinance causes a regulatory taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance." *Id.* at 530. The Court then cited *Nollan v. California Coastal Commission,* 483 U.S. 825, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987), which employs the "substantially advances" test.

The *Yee* Court went slightly further than in *Pennell* and held that the facial regulatory takings challenge was ripe. *See Yee,* 503 U.S. at 534. The Court did not reach the merits of the regulatory takings claim, however, because it concluded that the issue was not fairly presented in the certiorari petition. *See id.* at 537. In reaching that conclusion, the Court noted that "were we to address the issue here, we would apparently be the first court in the Nation to determine whether an ordinance like this one effects a regulatory taking." *Id.* at 538.

Although the Court recognized the novelty of the regulatory takings claim, it did not take any position on its merits. The ordinance in *Yee* is very similar to Act 257, in that the transfer of the mobile homes in *Yee* and the service station leaseholds here both create the possibility of a one-time transfer of wealth in the form of a premium that inures to incumbent lessees. Had the Court in *Pennell* rejected a regulatory takings challenge such as the one

posed by Chevron in the instant case, as the concurring opinion suggests, the Court in *Yee* would not have needed to expressly decline to reach the issue. We believe that the Court's treatment of the regulatory takings issue in *Yee* further undermines the concurrence's reading of *Pennell*.

City of Monterey v. Del Monte Dunes at Monterey, Ltd., 526 U.S. 687, 143 L. Ed. 2d 882, 119 S. Ct. 1624 (1999), gives additional support to the application of the "substantially advances" test to Chevron's Takings Clause claim. Although the Court recognized that it has not provided a "thorough explanation of the nature or applicability of the requirement that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions," it noted that the jury instructions given by the trial court regarding the "substantially advances" test were consistent with the Court's previous general discussions of regulatory takings liability. *Id.* at 704. As support for this statement, the Court cited several land use regulatory takings cases, including *Yee*. *See id.* It is apparent to us that the Court viewed the rent control ordinance in *Yee* in the same manner as the land use regulations in the other cases. It is further apparent to us that when challenged as a regulatory taking, each is subject to the same "substantially advances" test.

We have great difficulty finding Supreme Court precedent to support the concurring opinion's assertion that rent control should be viewed differently than other land use regulations. *Accord Santa Monica Beach, Ltd. v. Superior Court*, 19 Cal. 4th 952 968 P.2d 993, 1021 (Cal. 1999) (Baxter, J., dissenting) ("We cannot assume that decisions upholding other forms of price control are authority for rejecting a takings clause challenge to a rent control ordinance.").

The concurring opinion also does not satisfactorily explain how to deal with *Richardson*. *Richardson* is the law of our circuit and has conclusively answered the question of what test should be applied in this case. Nevertheless, the concurring opinion attempts to avoid the holding of *Richardson* by inventing a "certainty" requirement that does not exist. The concurrence would limit the "substantially advances" test to cases in which "the existence of the premium capture is essentially beyond dispute." We do not believe that *Richardson* may faithfully be read so narrowly.[4]

Finally, we note that other federal cases have applied the "substantially advances" test in considering a regulatory takings challenge to a rent control ordinance. *See Federal Home Loan Mortgage Corp. v. New York State Div. of Hous. and Community Renewal*, 83 F.3d 45, 48 (2d Cir. 1996) (concluding that rent stabilization law does not constitute either physical or regulatory taking); *Greystone Hotel Co. v. City of New York*, 13 F. Supp. 2d 524, 527-29 (S.D.N.Y.) (concluding that rent stabilization provision substantially advanced a legitimate state interest and thus did not effect a regulatory taking); *Adamson Cos. v. City of Malibu*, 854 F. Supp. 1476, 1501-02 (C.D. Cal. 1994) (concluding that city's mobile home rent control ordinance was substantially related to a legitimate interest).

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[4] We also do not believe that our decision today expands the holding of *Richardson*. We save for another day the question of whether the "substantially advances" test applies outside the context of rent control statutes that permit the capture of a premium.

In sum, we disagree with the concurrence's position that we should apply the "reasonableness" test to evaluate Chevron's regulatory takings claim. The correct test is "whether the legislation substantially advances a legitimate state interest," as discussed above, as suggested by the Supreme Court in *Yee*, as used by the district court in this case, and as established by this court in *Richardson*.

IV

Although the district court applied the correct standard, it should not have granted summary judgment. Notwithstanding the fact that both sides moved for summary judgment and agreed that summary judgment was appropriate one way or the other, genuine issues of material fact remain.[5]

We review a district court's grant of summary judgment de novo. *See Balint v. Carson City*, 180 F.3d 1047, 1050 (9th Cir. 1999) (en banc). We determine, viewing the evidence in the light most favorable to the nonmoving

[5] At least one court has held that, under similar circumstances involving cross-motions for summary judgment, a party that failed to raise the existence of genuine issues of material fact before the district court waived the right to do so on appeal. *See Shrink Missouri Gov't PAC v. Maupin*, 71 F.3d 1422, 1423 (8th Cir. 1995). Even then, however, the court proceeded to analyze whether genuine issues of material fact remained. The better-reasoned approach holds that the district court is responsible for determining whether the requirements of Federal Rule of Civil Procedure 56 are met, whether or not the parties believe that they are. *See, e.g.*, William W Schwarzer et al., *The Analysis and Decision of Summary Judgment Motions*, 139 F.R.D. 441, 499 (Feb. 1992) ("The filing of cross-motions does not ensure that summary judgment is in order.").

party, whether the district court correctly applied the relevant substantive law and whether there are any genuine issues of material fact. *See id.* Because Chevron challenges Act 257 on its face, rather than as applied, Chevron bears the burden of proving by a preponderance of the evidence that the regulation does not substantially advance a legitimate state interest. *See City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 700-01, 143 L. Ed. 2d 882, 119 S. Ct. 1624 (1999).

A

The State argues here that Chevron was not entitled to summary judgment because the district court ignored genuine issues of fact raised by the affidavit of its expert economist, Dr. Keith Leffler. Chevron, in its moving papers, relied solely on the stipulated fact that an existing dealer may be able to sell his leasehold at a premium that derives from the increased value of the dealer's leasehold interest due to the reduced rent imposed by Act 257. Based on this possible premium transfer, Chevron argued that the benefits of Act 257 will inure to the incumbent dealer, rather than to consumers. Thus, according to Chevron, Act 257 does not substantially advance its purpose of lowering gasoline prices.

The State relied on Dr. Leffler to rebut Chevron's argument. In his affidavit, Dr. Leffler asserted that Act 257 is likely to lessen the adverse competitive effects that result from the highly concentrated gasoline market in Hawaii and thereby benefit consumers. This is so, according to Dr. Leffler, because lower monthly rent payments reduce a dealer's cost of continued operation, meaning more dealers are likely to stay in business. The presence of

more dealers means a greater supply of fuel to consumers and a greater supply leads to lower prices. Therefore, Dr. Leffler predicted that the rent cap would act to lower retail gasoline prices. Although Dr. Leffler acknowledged that an oil company could raise the wholesale cost of gasoline to dealers in order to make up for lost rent, he believed that wholesale oil suppliers would be unlikely to do so because such action would lead directly to reductions in volume as dealers would react by raising their street price. He also believed that while a premium transfer was possible, an incumbent dealer could not be expected to capture the net present value of the reduced rent because the net present value would depend on too many unknown variables, such as the oil company's rent policy, the future level of gasoline margins, and the sales of goods other than gasoline. Even if new lessee dealers could estimate the present value of rent reductions accurately, Dr. Leffler stated that any cost reductions would be fully captured by incumbent dealers only if the market for the sale of lessee dealer rights was perfectly competitive. Relying on the stipulated facts, which indicate that less than three sales of dealer rights occur per year, Dr. Leffler concluded that the market is relatively thin, rather than perfectly competitive. Finally, because Act 257 encourages dealers to stay in business longer by lowering fixed costs, Dr. Leffler asserted that Act 257 will benefit consumers even if the premium is fully captured.

In response to Dr. Leffler, Chevron proffered an affidavit from its own expert economist Dr. John Umbeck. Dr. Umbeck's opinion differs significantly from that of Dr. Leffler. Dr. Umbeck believes that Act 257 will reduce the net present value of an oil company's rental revenue and thereby discourage oil companies from building new

stations or maintaining old ones. Accordingly, Dr. Umbeck asserted that Act 257 will actually increase the concentration of Hawaii's gasoline market, rather than decrease it. Because Dr. Umbeck believes that there will be fewer stations in the long run, he states that the demand facing surviving dealers will increase, thus motivating and allowing them to raise fuel prices. Finally, Dr. Umbeck disputes Dr. Leffler's conclusion that the market for the sale of lessee dealer rights is thin. Dr. Umbeck believes that the premium value of the capped rent will be fully captured by the incumbent dealer.

The conflicting affidavits establish that genuine issues of fact remain as to whether Act 257 will result in lower gasoline prices. Whether, and to what extent, Chevron will raise its wholesale price of fuel to compensate for lost rent, and whether, and to what extent, incumbent dealers will capture the value of the capped rent in the form of a premium upon transfer of the leasehold, remain as unanswered questions. Moreover, to the extent that the district court purported to answer these questions, such resolution was premature.[6]

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[6] That the district court engaged in improper fact-finding is apparent from its summary judgment order. For instance, the court found, despite evidence to the contrary, that "[b]ecause oil companies can simply raise their wholesale prices to the same extent that rent decreases, the dealer is likely to be unaffected by the rent cap, and gas prices will remain unchanged."

Because this case will be tried to the court, rather than a jury, the question arises whether it was improper for the district court to engage in fact-finding, since it will eventually be called upon to perform that very task. This court has held that if the parties agree that all of the underlying material facts are reflected in the written record, a judge may decide factual issues and essentially convert cross-motions for

(Continued on following page)

Admittedly, these are questions of predictive fact, rather than historical fact. Nevertheless, summary judgment is no more appropriate when predictive facts are disputed. *See Washington Post Co. v. United States Dep't of Health and Human Servs.*, 275 U.S. App. D.C. 101, 865 F.2d 320, 326 (D.C. Cir. 1989) (reversing summary judgment based on conflicting experts' predictions). In *Washington Post*, the plaintiff sought access under the Freedom of Information Act, 5 U.S.C. § 552, to certain financial

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summary judgment into submission of the case for trial on the written record. *See Starsky v. Williams*, 512 F.2d 109, 111 (9th Cir. 1975). The court noted, however, that that result was justified by the unique circumstances of that case. *See id.* Moreover, the court later cautioned that such fact-finding is not appropriate on an undeveloped factual record. *See TransWorld Airlines, Inc. v. American Coupon Exchange, Inc.*, 913 F.2d 676 (9th Cir. 1990). There, the court stated:

> [W]here the ultimate fact in dispute is destined for decision by the court rather than by a jury, there is no reason why the court and the parties should go through the motions of a trial if the court will eventually end up deciding on the same record. However, just as the procedural shortcut must not be disfavored, courts must not rush to dispose summarily of cases – especially novel, complex, or otherwise difficult cases of public importance – unless it is clear that more complete factual development could not possibly alter the outcome and that the credibility of the witnesses' statements or testimony is not at issue. Even when the expense of further proceedings is great and the moving party's case seems to the court quite likely to succeed, speculation about the facts must not take the place of investigation, proof, and direct observation.

Id. at 684-85. Although the parties in this case submitted a Stipulation of Facts, there is no clear indication, as there was in *Starsky*, that all of the relevant facts are contained in the written record. In fact, in the Stipulation itself, the parties clearly reserve the right to rely on other statements. Therefore, we hold that the district court erred in resolving factual disputes at this stage, even though it must do so later.

disclosure forms filed by National Cancer Institute consultants. *See* 865 F.2d at 321. The district court granted summary judgment in favor of the government. On appeal, the D.C. Circuit held that a genuine issue of material fact existed as to the effect of disclosure on the government's ability to obtain the information it needed from its scientist-consultants. *See id.* In so holding, the court reviewed the evidence in the record and concluded that the conflicting affidavits created a genuine issue of fact regarding the consequences of disclosing the sought-after information. The court explicitly rejected the trial court's explanation that resolution of this dispute involves an analysis of the potential, hypothetical impairment the government might suffer. . . . Due to the nature of the inquiry, there is no definitive proof that may be adduced by either side in support of their respective contentions. At best, the parties may provide the Court with speculation from individuals who speak with varying degrees of authority.

Id. at 324. The court held that the district court had "short-circuited the fact-finding process." *Id.* at 326. The court further explained that:

> "Factual" issues like those presented here are rarely susceptible to definitive proof. Rather, "factual" issues that involve predictive facts almost always require a court to survey the available evidence, to credit certain pieces of evidence above others, and to draw cumulative inferences until it reaches a judgmental conclusion. In the end, the court makes its best assessment about what is most likely to happen in the future. In such an inquiry, the ultimate "facts" in dispute are most successfully

> approached when all relevant evidentiary underpinnings are fully developed.

Id. at 326.

As in *Washington Post*, the experts' conflicting predictions here created genuine issues of fact. A proper evaluation of Act 257 depends upon further development of the experts' underlying facts. Although both experts based their opinions on the stipulated facts, they also rely on other unproven factual assumptions. In order to determine whose predictions are more accurate, there needs to be a better understanding of the competitiveness of the market for the sale and purchase of lessee dealer rights and the elasticity of demand for gasoline. This can be attained only through additional factual development and cross-examination of the parties' expert witnesses. Cross-examination is particularly appropriate here because it is necessary for the court to evaluate the witnesses' credibility in order to evaluate their expert opinions. By adopting the predictions of Chevron's expert without the benefit of this needed information, the district court "short-circuited the fact-finding process."

B

Issues of fact do not preclude summary judgment unless they are material to the substantive claim at issue, that is, unless they "might affect the outcome of the suit under the governing law." *Moreland v. Las Vegas Metro. Police Dep't*, 159 F.3d 365, 369 (9th Cir. 1998) (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986)). The factual disputes here are material only if their resolution would alter

whether Act 257 "substantially advances a legitimate state interest."

In order to determine materiality, we first determine what is required by the "substantially advances" test. Obviously, a connection of some sort must be established between Act 257's means (that is, a maximum regulated rent) and the intended end (lower gas prices). The question arises whether the mere possibility that the rent cap will not achieve its purpose is sufficient to destroy this nexus. The district court, relying on *Richardson*, believed this to be the case. If that belief is correct, the factual disputes are not material because the parties concede that that possibility exists. If, however, the standard requires a closer evaluation of the likelihood that the means will achieve the end, then these disputes are material.

In *Richardson*, we held that a Honolulu ordinance that imposed a cap on rent for land under condominium units was an unconstitutional regulatory taking. The court concluded that:

> The absence of a mechanism that prevents lessees from capturing the net present value of the reduced land rent in the form of a premium, means that the Ordinance will not substantially further its goal of creating affordable owner-occupied housing in Honolulu. Incumbent owner occupants who sell to those who intend to occupy the apartment will charge a premium for the benefit of living in a rent controlled condominium. The price of housing ultimately will remain the same. The Ordinance thus effects a regulatory taking.

124 F.3d at 1166. Importantly, our conclusion in *Richardson* was based on the district court's findings that incumbent

owners *will* charge a premium and that the price of housing *will* remain the same. Apparently, these findings were not contested on appeal.

Whether the price of gasoline will remain the same here is vigorously contested. The mere possibility that it will does not satisfy Chevron's burden of proving that Act 257 does not substantially further its purpose. Logically, there must be a determination of the likelihood of that possibility. Otherwise, regulatory legislation would be unconstitutional any time it was not absolutely guaranteed to achieve its purpose. Would a statute that was 95% likely to be effective fail to substantially advance its interest simply because there was a 5% chance that it would not achieve its goal? What if the statute was 99% effective? Surely the 1% chance that it would be ineffective does not, as a matter of law, mean that the statute does not "substantially advance" its purpose.

Not only does such a reading of *Richardson* fail the logic test, but it also fails to consider the language. Had the test been intended to require an absolute cause-and-effect relationship, the word "substantially" would have no meaning. For these reasons, the district court improperly relied on *Richardson* to conclude that the absence of a mechanism that prevents a premium transfer necessarily destroys the constitutionally-required connection.

The State argues that the existence of a premium is not relevant. As discussed in Section III above, however, the Supreme Court recognized this relevance in *Yee,* 503 U.S. at 530. While the existence of a premium transfer had nothing to do with a physical taking, the Court stated that "this effect might have some bearing on whether the ordinance causes a regulatory taking, as it may shed some

light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance." *Id.* The Supreme Court did not hold that the possibility of a premium transfer necessarily defeated that connection; it recognized only that it "might have some bearing" on it. *Id.*

The question remains as to what exactly the connection does require. In a candid statement, the Supreme Court recently acknowledged that is has not provided a "thorough explanation of the nature or applicability of the requirement that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions. . . . " *City of Monterey,* 526 U.S. at 704. In *City of Monterey,* the Court affirmed judgment in favor of Del Monte Dunes, a property owner who contended that the city's repeated rejections of its plans for development effected an unconstitutional regulatory taking. The Court held that the case was properly submitted to a jury. Although the Court refused to consider the City of Monterey's challenge to the jury instructions, as the City itself had proposed their essence, the Court nonetheless noted that the following jury instructions were consistent with the Court's previous discussions of regulatory takings liability:

> "Public bodies, such as the city, have the authority to take actions which substantially advance legitimate public interests. . . . So one of your jobs as jurors is to decide if the city's decision here substantially advanced any such legitimate public purpose."
>
> "The regulatory actions of the city or any agency substantially advance a legitimate public purpose

> of the action bears a reasonable relationship to that objective."
>
> "Now, if the preponderance of the evidence establishes that there was no reasonable relationship between the city's denial of the . . . proposal and legitimate public purpose, you should find in favor of the plaintiff. If you find that there existed a reasonable relationship between the city's decision and a legitimate public purpose, you should find in favor of the city. As long as the regulatory action by the city substantially advances their [sic] legitimate public purpose, . . . its underlying motives and reasons are not to be inquired into."

526 U.S. at 700-01. Based on these instructions, a challenged regulatory action "substantially advances" its interest if it bears a reasonable relationship to that interest.

Understanding what the "substantially advances" test requires also depends to some extent on understanding what it does not require. In *City of Monterey,* the Court declined to extend the "rough proportionality" test beyond the special context of exactions – land use decisions conditioning approval of development on the dedication of property to public use. *See id.* at 702-03. Thus, *City of Monterey* teaches that a reasonable relationship does not depend on the State's action being roughly proportional to its asserted interests.

Whether Act 257's rent cap is reasonably related to its objective of lowering fuel prices certainly depends on whether it will in fact lead to lower fuel prices. The factual issues that remain in dispute are material to the ultimate determination required in this action. We hold that the

district court should not have granted summary judgment on Chevron's first argument.

C

Because the judgment can be affirmed on any basis supported in the record, we briefly consider the second and third arguments made by Chevron in its summary judgment motion, even though the district court did not. There are two ways in which a party can challenge a regulatory action on its face. The first has been thoroughly discussed above. The second depends on whether the regulation deprives an owner of the economic viability of property. An owner is not denied the economic viability of property, unless there remains no permissible or beneficial use for that property after the regulatory action. *See City of Monterey,* 526 U.S. at 700 (quoting jury instruction to that effect). Chevron has made no such showing. In fact, the evidence shows that Act 257 allows Chevron to charge approximately $1.1 million more than it would otherwise have charged under its own rental program. Although this evidence may be useful to Chevron in demonstrating the ineffectiveness of Act 257, it belies its claim of loss of economic viability.

Chevron also argues that Act 257 is unconstitutional because it fails to provide for any individualized consideration and contains no mechanism for obtaining relief from the confiscatory rent limitation provisions. In support of this argument, Chevron relies on two state court cases and one of the two district court orders in *Richardson. See Cromwell Assocs. v. Mayor and Council of Newark,* 211 N.J. Super. 462, 511 A.2d 1273, 1275 (N.J. Super. Ct. Law Div. 1985); *Birkenfeld v. City of Berkeley,* 17 Cal. 3d 129,

550 P.2d 1001, 1028-1033, 130 Cal. Rptr. 465 (Cal. 1976); *Richardson v. City and County of Honolulu,* 802 F. Supp. 326, 336-37 (D. Haw. 1992) ("*Richardson II*"). The precedents established in these cases do not bind us. Although addressed by the district court in *Richardson II,* in *Richardson* we declined to reach the issue on appeal. Likewise, the Supreme Court in *Permian Basin Area Rate Cases,* 390 U.S. 747, 770, 20 L. Ed. 2d 312, 88 S. Ct. 1344 (1968), refused to decide whether individualized consideration and administrative relief were "constitutionally imperative." Earlier Supreme Court cases, however, have suggested that there are no such constitutional requirements. In *Bowles v. Willingham,* 321 U.S. 503, 518, 88 L.Ed. 892, 64 S. Ct. 641 (1944), the Court stated that otherwise valid price-fixing was not improper because it was on a class rather than an individual basis. Justice Brandeis stated for a unanimous Court in *Phillips v. Commissioner,* 283 U.S. 589, 596-97, 75 L.Ed. 1289, 51 S. Ct. 608 (1931), that "where only property rights are involved, mere postponement of the judicial enquiry is not a denial of due process, if the opportunity given for the ultimate judicial determination of the liability is adequate." As evidenced by the instant action, Chevron was not denied an opportunity to seek judicial review of Act 257.

Finally, the cases relied upon by Chevron – *Cromwell Associates, Birkenfeld,* and *Richardson II* – are distinguishable because they involved ordinances that regulated a landlord's sole source of revenue. Imposing a maximum rent removed the only mechanism by which a landlord could increase revenues in the event of an increase in costs. Chevron's lessee dealer stations provide Chevron

with two sources of revenue. For the past 20 years, Chevron has relied on its lessee dealers' contractually-required purchase of gasoline to assure a reasonable rate of return on its service stations. Act 257 does not regulate this revenue source. Accordingly, Act 257's failure to contain an administrative relief provision does not result in a facial taking.

V

Genuine issues of material fact exist as to whether Act 257 will benefit consumers. Specifically, the record contains conflicting evidence as to whether incumbent dealers will capture a premium based on the increased value of their leaseholds due to the imposition of a maximum permissible regulated rent, thereby depriving new dealers and consumers from reaping the benefits of Act 257. Questions also remain as to whether oil companies will raise the wholesale price of fuel and thereby unilaterally offset the benefits of the Act. Because resolution of these factual issues is necessary to determine whether Act 257 substantially advances, or bears a reasonable relationship to, the State's interest in lowering gasoline prices, the district court erred in granting summary judgment. Summary judgment is likewise inappropriate on the other two grounds urged by Chevron.

We VACATE the judgment of the district court and REMAND for further proceedings consistent with this opinion.

CONCUR BY: William A. Fletcher

CONCUR: W. FLETCHER, Circuit Judge, concurring in the judgment:

I disagree with the majority's analysis. Plaintiff Chevron challenges Hawaii Act 257, a rent control law limiting the amount an oil company can charge a dealer who leases a service station from the company. In a motion for summary judgment, Chevron argued that Act 257 is unconstitutional. The district court found Act 257 unconstitutional, granted Chevron's motion, and entered final judgment for Chevron. Defendant Cayetano timely appealed. We reverse and remand.

For the reasons that follow, I concur in the reversal of the grant of summary judgment to Chevron. I disagree, however, with the majority's rationale and with the task the majority has set for the district court on remand.

I

There are two distinct tests of constitutionality potentially applicable to Act 257. The first is a "reasonableness" test normally applied to rent control laws. The second is a "substantially advances a legitimate state interest" test normally applied to zoning and land use regulations. Relying on our earlier decision in *Richardson v. City and County of Honolulu,* 124 F.3d 1150 (9th Cir. 1997), the majority analyzes Act 257 under the second test. The problem in this case is not determining whether the majority has properly applied that test. The problem, rather, is determining whether the test should be applied at all.

An ordinary rent control law is constitutionally indistinguishable from a price control law. Rent control involves a price charged for real property, just as price control involves a price charged for personal property. The constitutional test for ordinary rent and price control laws

is the same, regardless of whether the laws are challenged under the Due Process Clause or the Takings Clause. The test has been variously formulated, but it essentially requires that the law be "reasonable" and "not confiscatory." A few examples illustrate the point.

In *Pennell v. City of San Jose,* 485 U.S. 1, 11, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988), the Supreme Court cited a rate regulation case in upholding a municipal rent control ordinance challenged under the Due Process Clause. The Court upheld the ordinance because it was not "'arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt. . . .' *Permian Basin Area Rate Cases,* 390 U.S. 747, 769-770, 20 L. Ed. 2d 312, 88 S. Ct. 1344 (1968)." In *FCC v. Florida Power Corp.,* 480 U.S. 245, 253, 94 L. Ed. 2d 282, 107 S. Ct. 1107 (1987), the Court upheld a rate regulation challenged under the Takings Clause as "not confiscatory." Citing the same rate regulation case as *Pennell,* it wrote that a regulation is permitted under the Constitution to "'limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness.'" *Id.* (citing *Permian Basin Area Rate Cases,* 390 U.S. at 769). In *In re Permian Basin Area Rate Cases,* the 1968 case cited in both *Pennell* and *FCC v. Florida Power,* the Court upheld a rate set by the Federal Power Commission without specifying whether the challenge was brought under the Due Process or Takings Clause: "any rate selected by the Commission from the broad zone of reasonableness . . . cannot properly be attacked as confiscatory." 390 U.S. at 770. In *Bowles v. Willingham,* 321 U.S. 503, 517, 88 L.Ed. 892, 64 S. Ct. 641 (1944), the Court upheld a federal rent control law after applying the same test as for a price control law: "Of

course, price control, the same as other forms of regulation, may reduce the value of the property regulated. But . . . that does not mean that the regulation is unconstitutional." Finally, in *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585, 86 L.Ed. 1037, 62 S. Ct. 736 (1942), the Court upheld a rate regulation challenged under the Due Process Clause because it was "reasonable" and "not confiscatory."

Beginning with *Agins v. City of Tiburon*, 447 U.S. 255, 65 L. Ed. 2d 106, 100 S. Ct. 2138 (1980), the Supreme Court developed a more stringent test of constitutionality for zoning and land use regulation cases. The zoning ordinance in *Agins* severely limited development of privately owned land in order to preserve open space for the community. The Court upheld the constitutionality of the ordinance against a regulatory taking challenge because the ordinance "substantially advanced legitimate state goals." *Id.* at 261. In *Nollan v. California Coastal Commission*, 483 U.S. 825, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987), the California Coastal Commission required owners of a beachfront house to grant a public easement across their property as a condition for receiving a permit to rebuild the house. Citing *Agins*, the Court stated, "Our verbal formulations in the takings field have generally been quite different [from those applicable to due process]. We have required that the regulation 'substantially advance' the 'legitimate state interest' sought be achieved, not that the State *could rationally have decided* that the measure adopted might achieve the State's objectives." *Id.* at 834 n.3 (emphasis in original; citations and internal quotations omitted). The Court further required that the easement have a connection, or "essential nexus," to the harm that would be caused by rebuilding the house.

Absent such a nexus, the required conveyance of an easement to the public would be nothing more than "extortion." *Id.* at 837. Finally, in *Dolan v. City of Tigard*, 512 U.S. 374, 129 L. Ed. 2d 304, 114 S. Ct. 2309 (1994), the city of Tigard, Oregon, required the owner of a commercial building to dedicate a portion of her property for parking and floodplain protection as a condition of receiving a permit to expand the building. The Court repeated the test from *Agins* and refined the *Nollan* "essential nexus" test. "A land use regulation does not effect a taking if it 'substantially advances legitimate state interests' and does not 'deny an owner economically viable use of his land.'" *Id.* at 385. Further, a "required dedication" from the landowner is constitutionally permissible if it bears a "rough proportionality" to the "nature and extent of the impact of the proposed development" for which the permit is sought. *Id.* at 391.

The Supreme Court has applied the "substantially advances a legitimate state interest" test of *Agins*, and its refinement in *Nollan* and *Dolan*, only in cases of severe zoning limitations on the use of land (*Agins*) and required dedications by landowners as a condition of receiving building permits (*Nollan* and *Dolan*). *See, e.g., City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 119 S. Ct. 1624, 1635-36, 143 L. Ed. 2d 882 (1999) ("We have not extended the rough proportionality test of *Dolan* beyond the special context of exactions – land-use decisions conditioning approval of development on the dedication of property to public use. . . . This Court has [not] provided . . . a thorough explanation of the nature or applicability of the requirement that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions."). In two

cases, however, the Supreme Court has hinted that, in special circumstances, a rent control law might amount to a regulatory taking and might therefore be subject to the "substantially advances a legitimate state interest" test.

In 1988, the Court considered a San Jose, California, rent control ordinance in *Pennell v. City of San Jose,* 485 U.S. 1, 99 L. Ed. 2d 1, 108 S. Ct. 849 (1988). The Court made clear that the ordinance, considered as a whole, should be analyzed under the normal reasonableness test:

> The standard for determining whether a state price-control regulation is constitutional under the Due Process Clause is well-established: "Price control is 'unconstitutional . . . if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt. . . .'" *Permian Basin Area Rate Cases,* 390 U.S. 747, 769-770, 20 L. Ed. 2d 312, 88 S. Ct. 1344 (1968).

485 U.S. at 11 (citation omitted). Applying this test, the Court sustained the rent control ordinance, holding that it represented "a rational attempt to accommodate the conflicting interests of protecting tenants from burdensome rent increases while at the same time ensuring that the landlords are guaranteed a fair return on their investment." *Id.* at 13.

The plaintiffs also brought a Takings Clause challenge to a specific provision in the ordinance that appeared to require a direct wealth transfer to a particular tenant based on the poverty of that tenant. Under the ordinance, a landlord seeking a rent increase of more than 8% was required to go before a hearing officer who was authorized to consider, among other factors, individual hardship.

If the proposed increase above 8% constituted "'an unreasonably severe financial or economic hardship on a particular tenant,'" the increase could be denied. *Id.* at 6. The landlords contended that denial of a proposed increase on that ground would constitute a taking, but the Court refused to decide the challenge, or even to specify a test for deciding it, because the provision had never been applied and a decision would therefore be "premature." *Id.* at 9.

Next, in *Yee v. City of Escondido,* 503 U.S. 519, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992), the Court addressed a takings challenge to an Escondido, California, mobile home rent control ordinance brought by owners of a mobile home park. As background to their challenge, the park owners pointed out that, despite their name, mobile homes are not mobile; once placed in a park, only about one mobile home in 100 is ever moved. *See id.* at 523. The park owners also pointed to California's Mobilehome Residency Law, which severely limited their ability to terminate mobile home owners' tenancies or prevent transfer of tenancies to purchasers of the mobile homes. The park owners contended that the rent control ordinance, when viewed against this background, amounted to a physical taking of their property. *See id.* at 525. The Court rejected this contention.

The park owners further contended that the ordinance constituted a regulatory taking, but the Court refused to consider the issue because it was not included in the grant of certiorari. However, in rejecting the plaintiffs' claim of physical taking, the Court wrote the following:

> The effect of the rent control ordinance, coupled with the restrictions on the park owner's freedom to reject new tenants, is to increase significantly the value of the mobile home. This increased

value normally benefits only the tenant in possession at the time the rent control is imposed. . . . Petitioners are correct in citing the existence of this premium as a difference between the alleged effect of the Escondido ordinance and that of an ordinary apartment rent control statute. Most apartment tenants do not sell anything to their successors (and are often prohibited from charging "key money"), so a typical rent control statute will transfer wealth from the landlord to the incumbent tenant and future tenants. By contrast, petitioners contend that the Escondido ordinance transfers wealth only to the incumbent mobile home owner. This effect might have some bearing on whether the ordinance causes a *regulatory* taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance. See *Nollan v. California Coastal Comm'n.* But it has nothing to do with whether the ordinance causes a *physical* taking.

Id. at 530 (citation omitted).

A panel of this court in *Richardson* relied on this passage from *Yee* in evaluating a Honolulu rent control ordinance. The ordinance limited long-term ground rents for residential condominiums and allowed condominium-owners/ground-lessees to sell their condominiums, and their leaseholds, without restriction. It was clear that by selling their condominiums and leaseholds, the condominium owners could, like the mobile home owners in *Yee,* capture a premium representing the present value of the difference between the controlled rent for the ground lease and the open market rent that would be charged in the absence of the ordinance. Because of this one-time wealth

transfer to the current condominium owners, *Richardson* treated the ordinance as a regulatory taking and applied the "substantially advances a legitimate state interest" test from *Agins, Nollan* and *Dolan*: "A land use regulation . . . does not effect a taking if it substantially furthers a legitimate state interest and does not deny the landowner economically viable use of his land. *Dolan,* 512 U.S. at 385." 124 F.3d at 1164. *Richardson* then struck down the ordinance because the ability of the owner to capture the premium by selling the condominium at an open market price meant that the ordinance did not "substantially further its goal of creating affordable owner-occupied housing in Honolulu." *Id.* at 1166.

The panel today greatly expands the holding in *Richardson.* Following the Supreme Court's suggestion in *Yee, Richardson* held that the "substantially advances a legitimate state interest" test was applicable in a case where it was clear that there was a premium resulting in a one-time wealth transfer from the landlord to the tenant. Absent such a transfer, the ordinance in *Richardson* would have been subject to the reasonableness test normally applied to rent control ordinances. In deciding whether to apply the "substantially advances a legitimate state interest test," the majority in this case does not first ask how clear it is that such a premium will be captured by the lessee. Rather, it treats *Richardson* as creating a presumptive rule that rent control laws are to be evaluated under the "substantially advances a legitimate state interest" test rather than the reasonableness test: "We established in *Richardson* that land use regulations, including rent control ordinances like Act 257, do not effect a taking if the regulation 'substantially furthers a legitimate state interest.' *Richardson,* 124 F.3d at 1164." *Maj. Op.* at 11723.

When the majority says that "rent ordinances like Act 257" are subject to the "substantially advances a legitimate state interest" test, it appears to mean that the mere possibility of a premium capture by an incumbent tenant is enough to render a rent control ordinance "like Act 257." It writes, "The stipulated *possibility* that an incumbent dealer will be able to capture the value of the decreased rent in the form of a premium separates Act 257 from an ordinary rent control situation[.]" *Maj. Op.* at 11725 (emphasis added). But the possibility of premium capture exists under virtually all rent control ordinances. Even under ordinances under which subleasing and assigning are prohibited, subleasing and assigning (and resulting premium capture) are nonetheless often commonplace.

We do not know in this case whether the tenants will, in fact, capture a premium. But even without knowing this, the majority has determined that the "substantially advances a legitimate state interest" test should be used to test the constitutionality of Act 257. The majority might respond that it does not matter that, at the time of determining what test to apply, the Court does not know whether a premium will be captured. That is, if upon investigation it turns out that there is no captured premium, the ordinance will pass the test. In other words, no harm, no foul. The problem with this response is that the constitutional test applied by the majority is not phrased in terms of whether a premium is captured. Rather, the test asks whether the rent control ordinance "substantially advances a legitimate state interest." Premium capture by the tenant is only one of many ways in which an ordinance can fail that test. Thus, if it turns out that there is, in fact, no premium capture, an ordinance may nonetheless be

struck down because it fails for some other reason substantially to advance a legitimate state interest.

Even if our decision in *Richardson* was right, I believe that the majority is wrong to expand it beyond the category of cases in which the existence of the premium capture is essentially beyond dispute. I believe that in expanding the holding of *Richardson,* the majority's opinion undermines or even contradicts the Supreme Court's decisions in ordinary rent control cases such as *Pennell* and *Bowles v. Willingham,* as well as threatens its decisions in price control cases such as *FCC v. Florida Power* and the *Permian Basin Area Rate Cases.*

II

If the majority confined itself to *Richardson,* it would not be able to apply the "substantially advances a legitimate state interest" test to the facts of this case. Under the suggested analysis in *Yee,* and as I read *Richardson,* the prerequisite to the application of that test is that there be a clear capture of the premium resulting from the rent control ordinance. Because there is no clear showing in this case that the premium will be captured by the lessees, the prerequisite for applying the test does not exist.

The factual foundation in this case is provided by a lengthy Stipulation of Facts filed in the district court. Stipulations 26 and 27 state that Chevron dealers can sell their dealerships (and associated leaseholds), and that the selling price is not limited either by Chevron's dealer lease or supply contracts or by Act 257. However, such a sale is subject to two conditions. First, Stipulation 30 states that Chevron could object to the sale in "good faith," as that term is defined by Hawaii Revised Statute § 486H-1: "The

petroleum distributor shall not impose on a gasoline dealer by contract, rule, or regulation, whether written or oral, any standard of conduct that is not reasonable and of material significance to the franchise relationship." It is not clear from the materials available to us whether Chevron would be acting in good faith within this definition if it allowed a dealer to sell a dealership and leasehold only on condition that the premium resulting from Act 257 be passed on to the new dealer in calculating the sale price. Stipulation 34 suggests that such a condition might be in good faith: "The existing dealer at the time of the enactment of Act 257 may be able to sell his leasehold at a premium that derives from the value of the dealer's leasehold interest, given the reduced rent imposed by Act, assuming that Chevron does not object in good faith when the selling dealer seeks Chevron's consent to the assignment." Second, Stipulation 26 states that Chevron may require the payment of an unspecified "transfer fee" as a condition of permitting the sale of a dealership. It is not clear from the materials before us whether such a transfer fee could include the premium resulting from Act 257.

Further, Act 257 only limits the amount of rent Chevron can charge its lessee-dealers. Chevron derives its revenue from them not only through rent, but also through the wholesale price for gasoline. Stipulation 15 states that Chevron requires its dealers, as a condition of their lease, to purchase Chevron-branded gasoline directly from Chevron. Stipulation 17 states, "Chevron recovers its expenses and investment costs of lessee dealer stations (e.g., ground-lease rent, real property taxes, ordinary maintenance, and depreciation) in Hawaii and throughout the United States through two principal revenue streams – rental revenue and earnings on Chevron gasoline sold

through the stations." Stipulation 9 states, "Under a supply contract, the lessee-dealer markets Chevron motor fuels, which the lessee dealer buys from Chevron, *at a price unilaterally determined by Chevron.* Chevron does not enter into a dealer lease unless the dealer simultaneously executes a supply contract with Chevron" (emphasis added).

It is thus entirely within Chevron's power to prevent its lessee-dealers from capturing any premium resulting from Act 257. Chevron may have that power pursuant to its ability to object in good faith to a sale or to impose a transfer fee. Chevron certainly has that power pursuant to its ability unilaterally to increase the wholesale price of the gasoline to its dealers. Indeed, the district court specifically discussed Chevron's ability to charge more for its gasoline and thereby to capture the premium: "Defendant's expert fails to explain why the oil company would not increase the wholesale price to simply offset the decrease in rent. . . . Neither Defendants nor Defendants' expert have offered any reason why this is not a feasible, and even likely, result."

I recognize that the district court also stated that "the Act . . . allows incumbent dealers to capture the value of the decreased rent in the form of a premium," but the court made the statement to show why the Act was not likely to achieve its purpose of lowering retail gasoline prices rather than to justify the application of the "substantially advances a legitimate state interest" test. The question under *Richardson* is not whether the terms of the Act themselves allow – i.e., do not prohibit – capture of the premium; rather, the question is whether the Act creates a situation where we know the premium will, in fact, be captured. As the district court noted, the "feasible, even

likely, result" is that Chevron will take that premium for itself in the form of higher wholesale prices charged to its dealers.

III

I fear that under the majority opinion virtually all rent control laws in the Ninth Circuit are now subject to the "substantially advances a legitimate state interest" test, and that this test may invalidate many of these laws. I will not undertake an extended analysis of the economic and social effects of rent control laws. Suffice it to say that the virtually unanimous opinion of economists is that, except in unusual and short-lived circumstances, they often do not achieve their stated purposes. They result in the creation of large and unwieldy bureaucracies. They do not subsidize the truly needy – the homeless and those in public housing; rather, they subsidize those already able to pay for their own housing, including many who can easily pay an open market price. They interfere with the normal play of free market forces, thereby creating incentives that result in reduced supplies of housing, reduced maintenance and repairs on existing housing, increased housing code violations, and increased transportation inefficiencies when tenants change schools or jobs but remain in rent-controlled housing.

The question before the judiciary is not the advisability of rent control laws but rather their constitutionality. Ever since its retreat from economic substantive due process at the end of the 1930s, the Supreme Court has essentially left it to the other branches of government to decide, in their political wisdom, whether to adopt rent and price controls. The Supreme Court's hints in *Pennell*

and *Yee* may signal a willingness to rethink this long-ago retreat, but at this point the Court has not yet done so.

I am not sure whether, in *Richardson,* we properly interpreted the Court's hints in *Yee* in concluding that the "substantially advances a legitimate state interest" test used in zoning and land use regulation cases should have been applied to the rent control ordinance in that case. I am inclined to think that we did not. I am sure, however, that the majority in this case extends *Richardson* beyond current law.

IV

It is not clear that Hawaii's Act 257 will result in the capture of a premium representing a one-time wealth transfer to dealers currently leasing stations from Chevron. Thus, even assuming that *Richardson* is good law, Act 257 should not be analyzed under the "substantially advances a legitimate state interest" test. Rather, Act 257 should be analyzed under the reasonableness test applicable to ordinary rent and price control laws. While I agree with the majority that the summary judgment granted to Chevron should be reversed, I disagree with the majority about the district court's task on remand. In my view, the district court should apply the reasonableness test applied – until today – to ordinary rent and price control laws.

CHEVRON U.S.A. INC., Plaintiff, vs. BENJAMIN J. CAYETANO, ET AL., Defendants.

CIV. NO. 97-00933 ACK

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAII

57 F. Supp. 2d 1003; 1998 U.S. Dist. LEXIS 22243

November 10, 1998, Decided
November 10, 1998, Filed

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JUDGES: Alan C. Kay, Chief United States District Judge.

OPINION BY: Alan C. Kay

OPINION:

ORDER RE: MOTIONS FOR SUMMARY JUDGMENT

SYNOPSIS

The Court is mindful of the strongly felt concerns of the legislature that Hawaii's consumers are paying too much for gasoline. However, the Court finds that Act 257 as crafted fails to substantially further this legitimate state interest, and therefore effects an unconstitutional taking.[1] Section 3(c) of Act 257, which limits rents that an oil company may charge its lessee dealers, fails to benefit dealers and consumers for two principal reasons. First, similar to the condominium tenants under the rent control ordinance declared unconstitutional in *Richardson v. City and County of Honolulu,* incumbent dealers are able to capture the value of reduced rent in the form of a premium upon sale of their leaseholds, and consequently, incoming lessee dealers are not benefitted by the Act. 124 F.3d 1150 (9th Cir. 1997), cert. denied, 119 S. Ct. 168, 142 L. Ed. 2d 137, 1998 WL 313049 (1998), and cert. denied, 119 S. Ct. 275, 142 L. Ed. 2d 227, 1998 WL 407121 (1998).[2] Second, since oil companies can offset rent reductions by increasing wholesale gasoline prices, they can unilaterally negate any benefit to be realized by dealers and consumers.

BACKGROUND

On June 21, 1997, the Hawaii Legislature, prompted by concerns regarding the relatively high price of gasoline charged to Hawaii consumers, enacted Act 257 of the Hawaii Revised Statutes. Act 257, inter alia, implements restrictions on gasoline manufacturers and jobbers in dealing with their retail dealers. Specifically, Section 3(c) of Act 257 ("the Act") restricts the amount of lease rent an

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[1] The Court notes the State of Hawaii has now pursued other means to rectify these concerns by filing suit against gasoline wholesalers in Hawaii, alleging, inter alia, they have engaged in price fixing.

[2] The Court notes that Act 257 was enacted before the Ninth Circuit Court issued its decision in *Richardson.*

oil company may charge a lessee dealer for use of a service station.

In response to the enactment of the Act, Plaintiff Chevron brought suit against Defendants Benjamin J. Cayetano, Governor of the State of Hawaii, and Margery S. Bronster, Attorney General of the State of Hawaii, challenging Section 3 of the Act as effecting an unconstitutional taking of Chevron's property in violation of the Fifth and Fourteenth Amendments of the United States Constitution. Section 3 of the Act reads, in pertinent part:

> (c) All leases as part of a franchise as defined in section 486H-1, existing on August 1, 1997, or entered into thereafter, shall be construed in conformity with the following:
>
> (1) Such renewal [of the lessee-dealer's leasehold] shall not be scheduled more frequently than once every three years; and
>
> (2) Upon renewal [of the leasehold], the lease rent payable shall not exceed fifteen percent of the gross sales, except for gasoline, which shall not exceed fifteen percent of the gross profit of product, excluding all related taxes by the dealer operated retail service station as defined in section 486H-1 and 486H-plus, in the case of a retail service station at a location where the manufacturer or jobber is the lessee and not the owner of the ground lease, a percentage increase equal to any increase which the manufacturer or jobber is required to pay the lessor under the ground lease for the service station. For the purpose of this subsection, "gross amount" means all monetary earnings of the dealer from a dealer operated retail service station after all applicable taxes, excluding income taxes, are paid. The provisions

> of this subsection shall not apply to any existing contracts that may be in conflict with its provisions.
>
> (d) Nothing in this section shall prohibit a dealer from selling a retail service station in any manner.

Haw. Rev. Stat. § 486H-10.4 (1997).

On January 28, 1998, Plaintiff filed a motion for partial summary judgment on its Second Claim for Relief. On July 30, 1998, Defendants responded and filed a cross motion for summary judgment on all claims in Plaintiff's complaint. On August 19, 1998, and August 28, 1998, Plaintiff and Defendants each filed their respective replies. The Court heard oral arguments on September 8, 1998. Both parties agreed that this case should be decided one way or the other on summary judgment.

SUMMARY JUDGMENT STANDARD

Summary judgment shall be granted where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). One of the principal purposes of the summary judgment procedure is to identify and dispose of factually unsupported claims and defenses. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986).

The United States Supreme Court has declared that summary judgment must be granted against a party who fails to demonstrate facts to establish an element essential to his case where that party will bear the burden of proof of that essential element at trial. *See Celotex*, 477 U.S. at

322. "If the party moving for summary judgment meets its initial burden of identifying for the court the portions of the materials on file that it believes demonstrate the absence of any genuine issue of material fact [citations omitted], the nonmoving party may not rely on the mere allegations in the pleadings in order to preclude summary judgment." *T.W. Elec. Serv. v. Pacific Elec. Contractors Ass'n,* 809 F.2d 626, 630 (9th Cir. 1987).

Rather, Rule 56(e) requires that the nonmoving party set forth, by affidavit or as otherwise provided in Rule 56, specific facts showing that there is a genuine issue for trial. *See T.W. Elec. Serv.,* 809 F.2d at 630. At least some "significant probative evidence tending to support the complaint" must be produced. *Id.* Legal memoranda and oral argument are not evidence and do not create issues of fact capable of defeating an otherwise valid motion for summary judgment. *See British Airways Bd. v. Boeing Co.,* 585 F.2d 946, 952 (9th Cir. 1978).

The standard for a grant of summary judgment reflects the standard governing the grant of a directed verdict. *See Eisenberg v. Ins. Co. of North America,* 815 F.2d 1285, 1289 (9th Cir. 1987) (citing *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 250, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1986)). Thus, the question is whether "reasonable minds could differ as to the import of the evidence." *Anderson,* 477 U.S. at 250-51.

The Ninth Circuit has established that "[n]o longer can it be argued that any disagreement about a material issue of fact precludes the use of summary judgment." *California Architectural Bldg. Products, Inc. v. Franciscan Ceramics, Inc.,* 818 F.2d 1466, 1468 (9th Cir. 1987). Moreover, the United States Supreme Court has stated that

"[w]hen the moving party has carried its burden under Rule 56(c), its opponent must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 586, 89 L. Ed. 2d 538, 106 S. Ct. 1348 (1986).

Indeed, "if the factual context makes the nonmoving party's claim *implausible,* that party must come forward with more persuasive evidence than would otherwise be necessary to show that there is a genuine issue for trial." *Franciscan Ceramics,* 818 F.2d at 1468 (emphasis in original) (citing *Matsushita,* 475 U.S. at 587). Of course, all evidence and inferences to be drawn therefrom must be construed in the light most favorable to the nonmoving party. *See T.W. Elec. Serv.,* 809 F.2d at 630-31.

DISCUSSION

I. Ripeness

Initially, the Court must determine whether Plaintiff's takings claim is ripe. As the Ninth Circuit noted in *Richardson,* there are two hurdles to a regulatory taking claim brought in federal court:

> The first hurdle, . . . that the plaintiff obtain a final decision regarding the application of the regulation to the property at issue from the entity charged with implementing the regulation . . . does not apply to facial regulatory takings claims. . . . The first hurdle thus does not apply to [Plaintiff's] argument.
>
> The second hurdle stems from the Fifth Amendment's proviso that only takings without 'just compensation' infringe that Amendment; 'if a State provides adequate procedure for seeking

> just compensation, the property owner cannot claim a violation of the Just Compensation clause until it has used the procedure and been denied just compensation.'

Richardson, 124 F.3d at 1165. Because Chevron's argument that Act 257 does not substantially advance a legitimate state interest does not depend upon the extent to which Chevron is compensated, its facial regulatory taking claim is ripe.

II. The Takings Clause

The Takings Clause of the Fifth Amendment of the United States Constitution states: "[N]or shall private property be taken for public use, without just compensation." U.S. Const., Amend. V. The United States Supreme Court has consistently distinguished "physical takings" from "regulatory takings." A physical taking occurs when a governmental entity authorizes a permanent physical occupation of real property. *See Yee v. City of Escondido,* 503 U.S. 519, 535, 118 L. Ed. 2d 153, 112 S. Ct. 1522 (1992). By contrast, the regulatory taking issue typically arises when a government regulation, such as a zoning regulation or a rent control law, affects a property owner's ability to use his land. *See id.* In the words of Justice Holmes, "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393, 415, 67 L. Ed. 322, 43 S. Ct. 158 (1922).

The Court notes that it is well established that legislative acts come to the Court with a presumption of constitutionality, *see Concrete Pipe & Products of California, Inc. v. Construction Laborers Pension Trust,* 508 U.S.

602, 637, 124 L. Ed. 2d 539, 113 S. Ct. 2264 (1993); *Duke Power Co. v. Carolina Environmental Study Group, Inc.,* 438 U.S. 59, 83-84, 57 L. Ed. 2d 595, 98 S. Ct. 2620 (1978); *Usery v. Turner Elkhorn Mining Co.,* 428 U.S. 1, 15, 49 L. Ed. 2d 752, 96 S. Ct. 2882 (1976), and therefore Plaintiff faces an uphill battle in its challenge to Act 257.

A. Facial Challenge

When a party alleges that an act of the legislature effects an unconstitutional taking, they may bring either a "facial" challenge or an "as applied" challenge. The Supreme Court has repeatedly held that a land use regulation will be found to effect a taking if it does not substantially advance a legitimate state interest or denies the landowner economically viable use of his land. *See Dolan v. City of Tigard,* 512 U.S. 374, 385, 129 L. Ed. 2d 304, 114 S. Ct. 2309 (1994); *see also, Lucas v. South Carolina Coastal Council,* 505 U.S. 1003, 1016, 120 L. Ed. 2d 798, 112 S. Ct. 2886 (1992); *Keystone Bituminous Coal Assn. v. DeBenedictis,* 480 U.S. 470, 485, 94 L. Ed. 2d 472, 107 S. Ct. 1232 (1987); *Agins v. Tiburon,* 447 U.S. 255, 260, 65 L. Ed. 2d 106, 100 S. Ct. 2138 (1980).

The relevant inquiry in a facial challenge is whether "mere enactment" of the challenged regulation effects a taking. *See Agins,* 447 U.S. at 260. For example, in *Agins,* the city of Tiburon adopted zoning ordinances that limited development of appellant's five-acre lot to a maximum of five single-family residences. Appellants brought suit against the city, alleging that the ordinances prohibited all development of their land and thus effected a taking of their property. The California Supreme Court rejected appellants' request for a declaration that the zoning

ordinances were facially unconstitutional, holding that the terms of the challenged ordinances allowed the appellants to construct between one and five residences on their property. *See id.* at 262.

The Supreme Court granted certiorari, and held that the ordinances substantially advanced legitimate governmental goals. *See id.* at 261. In reaching this decision, the Court considered the benefits of the ordinances as well as any diminution in market value that the appellants might suffer. The Court also considered appellants' allegations that they wished to develop the land for residential purposes, that the land was the most expensive suburban property in the State, and that the best possible use of the land was residential, and held that although the ordinances limited development, they neither prevented the best use of appellants' land or extinguished a fundamental attribute of ownership. The Court further held that the general plan advanced a legitimate state interest – protection from urbanization. Finally, the Court noted that the ordinance did not impose a burden solely on one landowner, it affected development generally, and therefore the public did not benefit at the expense of a few. *See id.*

Similarly, in *Richardson,* the plaintiff brought a facial challenge to a rent control ordinance that placed a cap on renegotiated ground rent that could be charged by the owner of the land under condominium units. *See* 124 F.3d at 1163. The Ninth Circuit first considered the typical condominium ground lease scheme, noting that since the land underneath condominiums is ordinarily owned by someone other than the condominium owner-occupant, the condominium owner must lease the ground underneath the unit for long periods. The court went on to find that although these leases are initially fixed for a term of years,

the rent is subject to renegotiation which typically is based on a percentage of the fair market value of the land appurtenant to the unit, exclusive of improvements, as of the date of the renegotiation. Finally, the court recognized that the ordinance at issue was enacted because the rapid rise in Hawaiian land prices often resulted in renegotiated rents several hundred times greater than the initial fixed rent. Nonetheless, the Ninth Circuit declared the ordinance facially invalid, holding that the absence of a mechanism to prevent owner-occupants from capturing a premium upon the resale of their unit meant that the ordinance would not substantially further its goal of creating affordable housing. *See id.* at 1166.

In the instant case, Plaintiff brings a facial challenge to Act 257, arguing that the rent cap provision of the Act effects an unconstitutional taking because it fails to substantially advance a legitimate state interest and it leaves Plaintiff with no economically viable use of its land.

B. Applicable Standard in Regulatory Takings Analysis

Defendants argue that Act 257 does not effect a taking, and is therefore constitutional. Moreover, Defendants claim that Plaintiff is applying the wrong standard in evaluating the state interest portion of the takings analysis.

According to Defendants, in order for the Act to pass constitutional muster, it is not necessary that the Act *actually* further the state interest involved, but merely that the Legislature rationally could have believed that the Act would do so. In support of this argument, Defendants cite *Hawaii Housing Authority v. Midkiff,* 467 U.S.

229, 81 L. Ed. 2d 186, 104 S. Ct. 2321 (1984). However, *Midkiff* dealt with a physical taking, rather than a regulatory taking, and is thus distinguishable from the present case. *See id.* at 233. In the physical taking context, the government exercises its eminent domain power to take private property for "public use." Furthermore, once the government decides to physically take property, it must provide just compensation to the person from whom the property was taken. At issue in *Midkiff* was the propriety of the purported "public use" advanced by the government to justify the taking. *See id.* at 235. The *Midkiff* Court held that the only requirement in a physical taking, since the taking is fully compensated, is that the legislature "rationally could have believed" the taking would serve the purported "public use." *See id.* at 242.

By contrast, the present case deals not with a physical taking, but with whether there has been a *regulatory* taking, an inquiry which requires a different analysis. In the regulatory taking context, the inquiry is not whether property has been taken for a public use, but rather, whether or not a government regulation substantially advances a legitimate state interest. As clarified in *Hall v. City of Santa Barbara,* 833 F.2d 1270 (9th Cir. 1986), *cert. denied,* 485 U.S. 940, 99 L. Ed. 2d 281, 108 S. Ct. 1120 (1988):

> In [*Midkiff*], the Court explored the meaning of the public use requirement in the Fifth Amendment's eminent domain clause. . . . The Court in *Midkiff* did not address the somewhat different articulation of the standard applicable in cases where there was no deliberate exercise of the eminent domain power. For example, it did not mention *Agins v. City of Tiburon* where it had noted that "the application of a general zoning

> law to a particular property effects a taking if the ordinance does not substantially advance legitimate state interests. . . . " The *Midkiff* Court left open the possibility that less deference would be afforded where government does not intend to effect a taking than where it does. . . . It makes considerable sense to give greater deference to the legislature where it deliberately resorts to its eminent domain power than where it may have stumbled into exercising it through actions that incidentally result in a taking.

833 F.2d at 1280. The United States Supreme Court echoed this viewpoint in *Nollan v. California Coastal Comm'n,* 483 U.S. 825, 835, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987), when it stated:

> We have required that the regulation [in the takings context] "substantially advance" the "legitimate state interest" sought to be achieved, not that "the state could rationally have decided" that the measure adopted might achieve the State's objective.

Id. Finally, the Ninth Circuit's opinion in *Richardson,* a case discussed by both parties in the instant case, further clarified this concept:

> The language used throughout *Midkiff* indicates that deference to the legislative body's public use determination is required when the taking is fully compensated. . . . [W]e believe that Nollan-Lucas-Dolan trio does not signal a change from this longstanding rule of deference because we see nothing inconsistent in applying heightened scrutiny when the taking is uncompensated, and a more deferential standard when the taking is fully compensated.

124 F.3d at 1158. Thus, the Court finds that, in order to determine whether the Act effects a taking, the appropriate inquiry is whether the Act substantially advances a legitimate state interest, not merely whether the legislature rationally believed it would do so.

C. Advancement of a Legitimate State Interest

The United States Supreme Court has not elaborated on the standards for determining what constitutes a "legitimate state interest" or what type of connection between a regulation and the state interest satisfies the requirement that the former "substantially advance" the latter. *Nollan*, 483 U.S. at 834. However, the Court has made clear that a broad range of governmental purposes and regulations satisfies these requirements. *See id.*

1. State Interests to be Advanced

Before determining whether a legitimate state interest is advanced by the Act, it is necessary to ascertain the specific state interests involved. Plaintiff argues that the purpose of Act 257 is to provide protection for service station lessee dealers. Defendants, however, assert that Act 257 is designed to protect consumers from the harmful effects of the highly concentrated petroleum market in Hawaii.

Defendants' contention is not without merit, for on its face, Act 257 appears to be directed toward the protection of consumers. Section 1 of Act 257 reads, in pertinent part:

> (1) The petroleum industry is an essential element of Hawaii's economy and is therefore of

> vital importance to the health and welfare of all people in the State of Hawaii; . . .
>
> (4) Because Hawaii is a physically small and geographically remote economy, certain of its markets tend to be concentrated. Market concentration is a function of the number of firms in the market and their respective market shares. In a highly concentrated market, market prices tend to rise above competitive levels. *Market prices persistently above competitive levels are harmful to consumers and the public.* Barriers to competition tend to cause supracompetitive prices to persist; and
>
> (5) The markets for oil and oil products in Hawaii are highly concentrated markets.

Haw. Rev. Stat. § 257 (1997) (emphasis added).

However, a closer examination of Act 257, specifically its legislative history, reveals another interest, namely "to provide certain protection for dealer operated retail service stations." Conf. Comm. Rep. 38, H.B. No. 1451 (1997).

While these two interests appear to be distinct from one another, they do not conflict. A thorough analysis of Defendants' argument reveals that in order to further the state's interest of protecting consumers, it is first necessary to help lessee dealers, whose viability might lead to a less concentrated – and thus more consumer friendly – market. Thus, the Court finds that while the legislature was mindful of the need to protect lessee dealers, this consideration was essentially a step toward the ultimate

goal of reducing gasoline prices for Hawaii's consumers.[3] Having ascertained the state interests to be advanced by Act 257, the Court's next task is to determine whether or not these interests are substantially advanced.

2. Advancement of State Interests

In support of its motion for partial summary judgment, Plaintiff argues that the Act fails to substantially advance a legitimate state interest. The Court agrees with Plaintiff, on two principal grounds.

a. New Dealers are Not Protected Because Incumbent Dealers Can Capture the Value of the Reduced Rent in the Form of a Premium

Defendants argue that the savings realized from reduced rent under the Act will lead to the continued business viability of independent dealers, keeping them in the market. They further argue that this, in turn, will lead to a less concentrated market, giving consumers more choices and lowering retail prices by way of increased competition.

Plaintiff argues, and the Court agrees, that the rent cap provision of the Act fails to protect new lessee dealers

[3] Even if the ultimate goal of the legislature was to help lessee dealers, Act 257 would still fail to substantially advance its purpose. As discussed below, incumbent lessee dealers can capture the value of the reduced rent in the form of a premium, thereby depriving incoming lessee dealers of the benefit of the rent cap. Similarly, oil companies can offset any decrease in rent with an increase in wholesale prices, and thereby eliminate the benefit to the lessee dealer.

because it allows incumbent dealers to capture the value of the decreased rent in the form of a premium. The existence of the rent cap makes an independent dealer's leasehold interest in a service station more valuable, and this added value becomes especially significant when an incumbent dealer undertakes to sell his interest. *See* Stipulation of Facts, ¶¶ 34, 35 at 10-11. Since the Act does not prohibit an incumbent dealer from selling his or her service station lease, the rent cap provision enables these dealers to sell their stations at a premium. *See id.* at ¶¶ 28, 29. Because the dealer to whom the interest is transferred will be required to pay the premium, the overall expense incurred by the incoming lessee dealer remains the same, and as a result, there are no savings to pass along to consumers.

In support of this argument, the Court finds *Richardson,* 124 F.3d at 1150, controlling. In *Richardson,* the Ninth Circuit addressed a rent control ordinance that placed a cap on renegotiated ground rent that could be charged by the owner of the land under condominium units. The ordinance was enacted for the purpose of providing affordable housing to owner-occupants. *Id.* at 1165. The trustees of the Bishop Estate, owner of the fee simple title to the land underneath condominiums that were affected by the ordinance, brought an action contesting the constitutionality of the ordinance. Since the owner-occupant of a condominium was free to transfer his or her "rent-controlled" leasehold interest, the owner-occupant was able to capture the value of that rent cap in the form of a premium. *Id.* at 1164. The ordinance was challenged by the plaintiff as an unconstitutional taking.

The Ninth Circuit affirmed the district court's finding that the ordinance effected a regulatory taking. According

to the Ninth Circuit, since the ordinance did not provide a mechanism to prevent the lessees from capturing the premium, the state interest in providing affordable housing was not substantially advanced, as ultimately the price of housing would remain the same. *Id.* at 1166.

Like *Richardson,* the possibility of a sales premium in the case at bar prevents the state interests from being substantially advanced. Act 257 fails to provide a mechanism to prevent dealers from capturing a premium. Indeed, cases like *Yee* and *Hall*[1] suggest that it is inappropriate, if not unconstitutional, to fail to provide a mechanism in rent control legislation to preclude the capture of a premium. *See Yee,* 503 U.S. at 527-31; *Hall,* 833 F.2d at 1279-80. Moreover, the potential for a premium in the present case is even more compelling than that in *Richardson,* since it is likely that a lessee dealer will find it easier to part with his or her business, than would a homeowner with his or her home. Presumably, a homeowner wishes to remain where he or she lives, whereas a businessperson is likely to view maximization of profits as the ultimate business goal. Thus, because an independent dealer can unilaterally negate any benefit a transferee might receive from the Act, it fails to substantially advance the state's interest in protecting new dealers.

Defendants argue that *Richardson* is distinguishable from the present case because the purpose of Ordinance 91-96, which was at issue in *Richardson,* and the purpose of Act 257 are distinct. The primary goal of Ordinance 91-96 was to provide affordable housing for owner-occupants of condominiums subject to ground leases. The "Findings and Purpose" section of Ordinance 91-96 states, in relevant part:

> The council finds that:
>
> * * *
>
> (3) . . . owner-occupants of condominium[s] . . . were not informed . . . of lease rent renegotiation . . . terms . . . of the lease, [which are] established unilaterally by the lessors. . . . ;
>
> (5) . . . Unless controlled, the renegotiated lease rents may be unaffordable to many owner-occupants of leased condominium housing units . . . ;
>
> (6) . . . owner-occupants may have no recourse but to terminate their leases or sell . . . and seek housing elsewhere . . . ;
>
> (7)(E) Residential leaseholds have also undesirable social effects . . . [because] as the lessee advances in age, [the] lessee's income potential declines, . . . causing the lessee to give up the lease . . . ;
>
> * * *
>
> The council further finds and declares:
>
> * * *
>
> (3) . . . lease rent increases of 1,000 percent would make home ownership unaffordable to a substantial number of owner-occupants of residential condominiums. . . .

Honolulu City and County, Haw. Ordinance 91-96 § 1. Defendants argue that unlike the ordinance at issue in *Richardson,* which was enacted to provide affordable housing, the purpose of Act 257 is not to provide affordable gas station purchases, but rather, to benefit consumers. Thus, even if transferee dealers are negatively impacted

by a premium, according to Defendants, incumbent dealers will still benefit from the rent cap and will thus pass along their savings to consumers, who will thereby benefit as well. The Court disagrees.

First of all, in *Richardson,* although the owner-occupants who retained their condominiums would clearly receive a direct benefit from the rent cap each month, the Ninth Circuit nonetheless declared the Ordinance unconstitutional because it failed to prevent owners of condominiums from capturing a premium upon the sale of their units, thereby depriving the purchasers of any benefit from the rent cap and resulting in the price of housing ultimately remaining the same. Moreover, while it is possible that some lessee dealers may benefit from the Act's rent cap in the form of lower overall costs, there is no reason to conclude that such dealers will react to this savings by lowering their retail prices. Dealers may instead elect to maintain a higher profit margin, since the Act includes no mechanism to prevent lessee dealers from simply keeping their prices the same and retaining the profit from the reduced rent on a month-to-month basis. Nothing has been presented to the contrary.[4]

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[4] The parties agree that under current conditions, Act 257's rent cap will only affect 11 of Chevron's 64 lessee dealer stations in Hawaii. *See* Stipulation of Facts, ¶ 6 at 4. Thus, less than 20 percent of Chevron's stations will be impacted by the rent cap. No evidence has been presented as to how the Act affects the remaining non-Chevron stations.

The Court nonetheless finds that Act 257 fails to substantially advance a legitimate state interest, because it is probable that consumers will not benefit from the rent cap as applied to these remaining stations. First, it is possible that, like 53 of Chevron's lessee dealer stations, the Act will not impact these other stations at all. If this is the case, then the Act will certainly not benefit consumers, since prices at

(Continued on following page)

b. Incumbent Dealers Are Not Protected Because Rent Reductions Can Be Offset By Wholesale Price Increases

Defendants also argue that since the rent cap provision of the Act helps incumbent dealers to maintain their viability, the market will be less concentrated, giving the consumer more choices. They go on to argue that this lowered concentration means more competition and thus lower retail prices. The Court finds it unlikely that the Act will lead to such a result.

There is no dispute that Plaintiff receives income from dealers in the form of both rent and fuel sales. Importantly, the Act does not place any limitation on the price of fuel sales. Thus, an oil company can raise fuel prices to

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these stations will remain unchanged. Second, even if the Act were to impact these stations, there is no mechanism to prevent incumbent dealers from capturing a premium upon the sale of their stations, as discussed at length above. Therefore, under either scenario, Act 257 does not substantially advance the state's interest in benefitting consumers.

Furthermore, even in the absence of a captured premium, the Act still fails to advance its purpose. As discussed infra, and as acknowledged by the government, Chevron can merely offset the decreased rent by increasing their gasoline prices, thereby negating any benefit to be achieved by the Act. The Court finds no reason why other oil companies would not act likewise. In light of these considerations, it is highly unlikely that the minimal number of dealers who might be benefitted by the Act would make a competitive impact if they were to lower their prices.

Finally, the fact that Act 257 allows Chevron to charge approximately $1.1 million more than it would otherwise have charged under its own rental program further demonstrates the Act's ineffectiveness in its purpose of protecting consumers. *See* Stipulation of Facts, Table 1.

compensate for the reduction in rent, and as a result, dealers will not receive any benefit from the rent cap.[5]

Defendants argue that although oil companies are free to raise fuel prices to offset any reduction in rent, they will not do so.[6] Defendants' expert states that an increase in wholesale fuel prices by an oil company would lead the

[5] In fact, Defendants have acknowledged this possibility in their brief. Defendants' brief reads, in relevant part:

> In contrast, Chevron's lessee dealer gas stations provide Chevron with two sources of revenue. Chevron uses both to pay the expenses it incurs in leasing the service stations. The first source is the contract rent that is subject to Act 257. The second source of revenue is from the sale of Chevron gasoline to lessee dealers which lessees are required to purchase from Chevron under the supply agreement Chevron requires of the dealer lessees. The revenue which Chevron receives from its gasoline sales is substantially greater than the contract rent. Act 257 does not impose a cap on the amount Chevron may charge for gasoline and other products it sells its lessee dealers. Therefore, Act 257 does not deprive Chevron of the ability to increase the DTW price, Chevron's primary revenue stream from its lessee stations, in the event of an increase in costs.

See Def.'s Mot. for Summ. J., p. 28-29 (citations omitted).

[6] Plaintiff's expert disagrees. It is evident from Plaintiff's expert's declaration that this can and will occur in response to a reduction in rent. *See* Declaration of John R. Umbeck, p. 3, ¶ 5(b); p. 8, ¶ 16; p. 11, ¶ 21. According to Plaintiff's expert, Act 257 will (1) penalize Chevron and its lessee dealers, reducing their viability in Hawaii; (2) penalize consumers because it can be expected to lead to higher retail gasoline prices; (3) not benefit future lessee dealers because dealers can capture the value of the rent cap in the form of a premium; and (4) not permit Chevron to earn a reasonable return on its investments. *See id.* at p. 3, ¶ 5. By contrast, Defendants' expert claims that Act 257 will (1) benefit consumers by decreasing the concentration in the gasoline market; (2) benefit both incumbent and transferee dealers; and (3) provide Chevron a reasonable return on its investment. *See* Declaration of Keith B. Leffler, p. 4-5, ¶ 7.

dealer to increase his retail fuel prices. This increased retail price, according to Defendants, would result in a decreased volume of fuel sales, which would ultimately hurt the oil company. However, Defendants' expert fails to explain why the oil company would not increase the wholesale price to simply offset the decrease in rent.[7] Indeed, there is no economic reason why a shift from paying a certain sum as "rent" to paying that same sum as "fuel price" would lead a dealer to react by raising his gas prices when his overall costs remain the same. By doing so, he would be acting against his own interest, running the risk of decreased sales because of the increased prices. Instead, it is likely that if a dealer's overall costs remain the same, he will choose to remain competitive by keeping his retail prices the same. Because oil companies can simply raise their wholesale prices to the same extent that rent decreases, the dealer is likely to be unaffected by the rent cap, and gas prices will remain unchanged.[8] Consequently, the Act's purpose of protecting the dealer – and thereby protecting the consumer – would not be met.

Since Chevron's Dealer Supply Contract allows a lessee dealer to purchase fuel from suppliers other than

[7] Neither Defendants nor Defendants' expert have offered any reason why this is not a feasible, and even likely, result.

[8] Although Defendants might argue that an oil company may not be able to accurately assess the amount of increase in wholesale price needed to offset the decrease in rental income, the parties agree that, where an economic benefit or loss is difficult to quantify, on average, the participants will estimate accurately. *See Declaration of Keith B. Leffler,* p. 11-12, ¶ 16 (discussing accuracy of estimating value of rent cap in order to calculate premium); *Declaration of John R. Umbeck,* p. 12, ¶ 22; p. 13, ¶ 24 (discussing estimation of rent cap value).

Chevron, one might argue that if Chevron were to offset the decreased rent as described above, a dealer would simply "go elsewhere" to purchase his fuel. However, the Court finds that this is neither a feasible nor practical alternative. First, the terms of the Dealer Supply Contract state that a lessee dealer must purchase from Chevron all fuel that is necessary to fulfill customer demand for Chevron gasoline. Thus, even if a dealer wishes to discontinue Chevron gasoline and sell another brand, he may not do so if a demand for Chevron gasoline exists. Second, according to the Dealer Lease, if a lessee dealer chooses to market and sell other gasoline, he must install his own pumps and tanks, and he must make it clear to consumers that the fuel contained therein is not Chevron fuel. As stipulated to by the parties, there are only two local refinery sources: Chevron, which supplies sixty percent of the gasoline produced or refined in Hawaii, and Tesoro, which supplies forty percent. *See* Stipulation of Facts, ¶ 38 at 11. Therefore, if a dealer chose to obtain gasoline from another source, it would be cost-prohibitive without some sort of "concerted action," since importing gasoline requires purchasing a large quantity and chartering a vessel to transport it. Because this is not a realistic alternative, the Court finds that a lessee dealer's mere ability to purchase fuel from other sources does not negate the probability that an oil company such as Chevron and Tesoro could be successful in defeating the rent cap by offsetting decreased rent with increased fuel prices.

For all of the reasons outlined above, the Court finds that Section 3(c) of Act 257 fails to substantially advance a

legitimate state interest, and as such, effects an unconstitutional taking in violation of the Fifth and Fourteenth Amendments of the Constitution.[9],[10]

III. Other Claims

Plaintiff moved for partial summary judgment only on its Second Claim for Relief, while Defendants moved for summary judgment on all claims. Defendants failed to satisfy their burden on Plaintiff's First, Third, Fourth, Fifth, Sixth, and Seventh Claims for Relief, because they did not present any evidence which demonstrates that there is no genuine issue of material fact as to those claims. This is particularly true with regard to Plaintiff's First Claim for Relief (Deprivation of Constitutional Rights in Violation of 42 U.S.C. § 1983) and Fifth Claim for Relief (impermissible taking in violation of the Hawaii Constitution), inasmuch as the Court finds that Act 257 effects an unconstitutional taking. Accordingly, summary judgment on those claims is DENIED.

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[9] While the Court recognizes that Plaintiff brings a facial challenge to Act 257, the Court notes that Act 257 has been in operation since June of 1997, and yet the state claims in its lawsuit filed on October 1, 1998, which alleges antitrust violations, that the price of gasoline for consumers is an average of $.30 per gallon higher than prices on the mainland This further illustrates the ineffectiveness of Act 257 in its purpose of benefitting consumers. However the Court has not considered the foregoing in reaching its decision.

[10] Plaintiff also challenges the Act as effecting an unconstitutional taking on two alternate grounds: (1) that it leaves them with no economically viable use of their land, and (2) that the Act fails to provide for individualized consideration. Because the Court finds that the Act fails to substantially advance a legitimate state interest, it need not address these alternate arguments.

In their brief, Defendants represented that Plaintiff "announced" that it would not pursue its due process and equal protection claims. However, the Court does not find anything in the record which indicates that Plaintiff abandoned these claims. If it can be established that Plaintiff did make such a withdrawal, Defendants are entitled to summary judgment on the Third, Fourth, Sixth, and Seventh Claims for Relief.

CONCLUSION

The Court finds that Act 257 fails to substantially advance a legitimate state interest, and as such, effects an unconstitutional taking in violation of the Fifth and Fourteenth Amendments of the United States Constitution. For the foregoing reasons, the Court hereby GRANTS Plaintiff's motion for summary judgment on its Second Claim for Relief.

IT IS SO ORDERED.

DATED: Honolulu, Hawaii, NOV 10 1998

Alan C. Kay

Chief United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHEVRON USA, INC., a Pennsylvania Corporation Plaintiff-Appellee, v. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; EARL I. ANZAI*, Attorney General of the State of Hawaii, Defendants-Appellants.	No. 99-15108 D.C. No. CV-97-00933-ACK AMENDED ORDER (Filed Oct. 31, 2000)

Before: D.W. NELSON, BEEZER, and W. FLETCHER, Circuit Judges.

The majority of the panel has voted to deny the petition for rehearing. Judge W. Fletcher voted to grant the petition for rehearing. Judges D. Nelson and Beezer recommended denying the petition for rehearing en banc. Judge W. Fletcher votes to grant the petition for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no judge in active service has requested a vote to rehear the matter en banc. Fed. R. App. P. 35.

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* Earl I. Anzai is substituted for his predecessor Margery S. Bronster, as Attorney General for the State of Hawaii. Fed. R. App. P. 43(c)(2).

The petitions for rehearing and rehearing en banc are DENIED.

Hawaii revised statutes, Chapter. § 486H-10.4 Restrictions on manufacturers or jobbers in operating service stations; lease rent controls; definitions.

(a) Beginning August 1, 1997, no manufacturer or jobber shall convert an existing dealer operated retail service station to a company operated retail service station; provided that nothing in this section shall limit a manufacturer or jobber from:

(1) Continuing to operate any company operated retail service stations legally in existence on July 31, 1997;

(2) Constructing and operating any new retail service stations as company operated retail service stations constructed after August 1, 1997, subject to subsection (b); or

(3) Operating a former dealer operated retail service station for up to twenty-four months until a replacement dealer can be found if the former dealer vacates the service station, cancels the franchise, or is properly terminated or not renewed.

(b) No new company operated retail service station shall be located within one-eighth mile of a dealer operated retail service station in an urban area, and within one-quarter mile in other areas. For purposes of this subsection, "urban" means the first congressional district of the State, and "other areas" means the second congressional district of the State.

(c) All leases as part of a franchise as defined in section 486H-1, existing on August 1, 1997, or entered into thereafter, shall be construed in conformity with the following:

(1) Such renewal shall not be scheduled more frequently than once every three years; and

(2) Upon renewal, the lease rent payable shall not exceed fifteen percent of the gross sales, except for gasoline, which shall not exceed fifteen per cent of the gross profit of product, excluding all related taxes by the dealer operated retail service station as defined in section 486H-1 and [this section] plus, in the case of a retail service station at a location where the manufacturer or jobber is the lessee and not the owner of the ground lease, a percentage increase equal to any increase which the manufacturer or jobber is required to pay the lessor under the ground lease for the service station. For the purposes of this subsection, "gross amount" means all monetary earnings of the dealer from a dealer operated retail service station after all applicable taxes, excluding income taxes, are paid. The provisions of this subsection shall not apply to any existing contracts that may be in conflict with its provisions.

(d) Nothing in this section shall prohibit a dealer from selling a retail service station in any manner.

(e) For the purposes of this section:

"Company operated retail service station" means a retail service station owned and operated by a manufacturer or jobber and where retail prices are set by that manufacturer or jobber.

"Dealer operated retail service station" means a retail service station owned by a manufacturer or jobber and operated by a qualified gasoline dealer under a franchise.

"Operate" means to engage in the business of selling motor vehicle fuel at a retail service station through any

employee, commissioned agent, subsidiary company, or person managing a retail service station under a contract and on a fee arrangement with the manufacturer or jobber.

"Retail" means a sale of gasoline made to the general public at prices that are displayed on the dispensing equipment.

CONFERENCE COMMITTEE
REPORT NO. 38

Honolulu, Hawaii
April 24, 1997
RE: H.B. No. 1451
H.D. 1
S.D. 1
C.D. 1

Honorable Joseph M. Souki
Speaker, House of Representatives
Nineteenth State Legislature
Regular Session of 1997
State of Hawaii

Honorable Norman Mizuguchi
President of the Senate
Nineteenth State Legislature
Regular Session of 1997
State of Hawaii

Sir:

Your Committee on Conference on the disagreeing vote of the House of Representatives to the amendments proposed by the Senate in H.B. No. 1451, H.D. 1, S.D. 1, entitled:

"A BILL FOR AN ACT RELATING TO THE PETROLEUM INDUSTRY,"

having met, and after full and free discussion, has agreed to recommend and does recommend to the respective Houses and final passage of this bill in an amended form.

The purpose of this bill as received is to:

(1) Repeal chapters 486E and 486I, Hawaii Revised Statutes (HRS), to consolidate petroleum industry reporting under the department of business, economic development, and tourism;

(2) Amend chapter 486H, HRS, to add a new section to provide certain restrictions on company operated retail service stations and provide certain protection for dealer operated retail service stations.

Your Committee has amended this measure to:

(1) Add legislative findings and declarations;

(2) Rename -5, "summary reports", to "analysis of information; audits and inspections; summary reports", and to include the expanded language of the original bill;

(3) Add a new section, -11, powers of the public utilities commission;

(4) Add a new part II, petroleum advisory council, establishment, and duties;

(5) Delete proposed language in 486H –, related to acquiring in any manner existing company operated or dealer operated retail service stations;

(6) Delete the proposed ratio language concerning company operated to dealer operated;

(7) Change distance between new company operated stations and dealer operated stations from two miles to one-eighth mile in an urban area, and one-quarter mile in other areas, and define the terms "urban" and "other areas";

(8) Amend the proposed lease renewal language to further clarify the lease rent caps provided that these provisions shall not apply to any existing contracts that may be in conflict with the provisions.

(9) Add language that nothing in the section shall prohibit a dealer from selling a retail service station;

(10) Repeal section 486H-10, Hawaii Revised Statutes;

(11) Delete the instructions to the revisor of statutes; and

(12) Make technical, nonsubstantive amendments for the purpose of clarification and to follow standard drafting format.

Your Committee on Conference is in accord with the intent and purpose of H.B. No. 1451, H.D. 1, S.D. 1, as amended herein, and recommends that it pass Final Reading in the form attached hereto as H.B. No. 1451, H.D. 1, S.D. 1, C.D. 1.

Respectfully submitted,

MANAGERS ON THE PART OF THE SENATE	MANAGERS ON THE PART OF THE HOUSE
/s/ Rosalyn H. Baker ROSALYN H. BAKER, Co-Chair	/s/ Terry Nui Yoshinaga, TERRY NUI YOSHINAGA, Co-Chair
/s/ David Y. Ige DAVID Y. IGE, Co-Chair	/s/ Ron Menor RON MENOR, Co-Chair
/s/ Malama Solomon MALAMA SOLOMON, Member	/s/ Terrance W.H. Tom TERRANCE W.H. TOM, Co-Chair
	/s/ Brian Yamane BRIAN YAMANE, Member